Explanatory Notes to Legislation Relating to Income Tax

Issued by
The Honourable Paul Martin, P.C., M.P.
Minister of Finance

May 1994

Canada

Explanatory Notes to Legislation Relating to Income Tax

Issued by
The Honourable Paul Martin, P.C., M.P.
Minister of Finance

May 1994

Department of Finance
Canada

Ministère des Finances
Canada

These explanatory notes are provided to assist in an understanding of amendments to the *Income Tax Act*, the *Income Tax Application Rules*, the *Canada Pension Plan*, The *Canada Business Corporations Act*, the *Excise Tax Act*, the *Unemployment Insurance Act* and certain related Acts. These notes are intended for information purposes only and should not be construed as an official interpretation of the provisions they describe.

Cette publication est également offerte en français.

Cat. No. F2-97/1994E

ISBN 0-662-21588-5

PREFACE

The legislation to which these explanatory notes relate contains amendments to the *Income Tax Act*, the *Income Tax Application Rules*, the *Canada Pension Plan*, the *Canada Business Corporations Act*, the *Excise Tax Act*, the *Unemployment Insurance Act* and certain related Acts.

These explanatory notes describe amendments, clause by clause, for the assistance of Members of Parliament, taxpayers and their professional advisors.

The Honourable Paul Martin
Minister of Finance

Table of Contents

Clause 1

Source of Income or Loss

ITA
4

Section 4 of the Act provides general rules for determining a taxpayer's income or loss from a particular source or from a source in a particular place.

Subclause 1(1)

ITA
4(2)

Subsection 4(2) of the Act provides that deductions permitted by sections 60 to 63 of the Act are not applicable to a particular source or to sources in a particular place, except as provided by subsection 4(3). This amendment to subsection 4(2) adds a reference to section 64 of the Act, under which an individual may deduct attendant care expenses. This amendment applies to 1989 (the first year for which attendant care expenses were deductible in computing income) and subsequent years.

Subclause 1(2)

ITA
4(3)

Subsection 4(3) of the Act applies to a source of income or loss of a taxpayer that is an office, employment or business carried on or performed by the taxpayer in more than one place. With a few exceptions, it provides that, for the purposes of determining the taxpayer's foreign tax credit and the taxpayer's taxable income earned in Canada, all deductions allowed in computing the income of the taxpayer are considered to be applicable to a particular source or to sources in a particular place. The exceptions are for deductions permitted by paragraphs 60(b) (alimony payments), 60(c) (maintenance payments), 60(d) (interest on death duties) and 60(i) (RRSP deductions).

Subsection 4(3) is amended so that it applies to all sources of income, whether or not the source of income relates to more than one place.

Subsection 4(3) is also amended to expand the list of deductions under section 60 which are not allocable to any source of income. The expanded list includes deductions in respect of Canadian deferred income plans, payments from which will ultimately be taxable in Canada. This is intended to allow an individual who pays foreign tax in respect of a transfer to such a plan access to the foreign tax credit under subsection 126(1) of the Act for the year of the transfer. More specifically, all deductions permitted by section 60 are now on this list, other than deductions permitted by paragraph 60(a) (capital element of annuity payment), paragraph 60(o.1) (legal expenses), paragraph 60(q) (repayment of scholarships, bursaries and research grants), paragraph 60(s) (repayment of policy loan) and paragraphs 60(t) to (u) (retirement compensation arrangement payments).

Subsection 4(3) of the Act is also amended to ensure that it applies for the purposes of the "flow-through" of foreign source income from a trust to its beneficiaries. This is achieved by a reference to subsection 104(22) and new subsection 104(22.1) of the Act, under which the flow-through mechanism formerly contained exclusively in subsection 104(22) will now be provided.

Finally, subsection 4(3) is amended to ensure that deductions made by a trust under subsection 104(6) (amounts paid or payable to beneficiaries) and subsection 104(12) (amounts allocated to preferred beneficiaries) are not considered to be applicable to sources in a foreign country. However, if a trust designates such amounts in favour of its beneficiaries under subsection 104(22), new subsection 104(22.2) (formerly paragraph 104(22)(c)) requires that the trust's foreign source income be reduced in a corresponding manner.

These amendments apply to taxation years commencing after 1992, except that the relieving aspects of the amendments to subsection 4(3) apply to taxation years ending after November 12, 1981.

Clause 2

Income From Office or Employment

ITA
6

Section 6 of the Act deals with employment income and provides for the inclusion of employment-related benefits in an employee's income.

Subclause 2(1)

ITA
6(1)(a)(iii)

Subparagraph 6(1)(a)(iii) of the Act is amended consequential on the addition of new paragraphs 6(1)(k) and (l) which require an employee to include in income an amount representing any automobile operating expenses benefit enjoyed by the employee. Accordingly, any benefit in respect of the operation of an automobile will no longer be included in income under paragraph 6(1)(a), but rather under new paragraph 6(1)(k) or (l). This amendment applies to 1993 and subsequent taxation years.

Subclause 2(2)

ITA
6(1)(b)(xi)

Subparagraph 6(1)(b)(xi) of the existing Act provides that if an employee receives both an allowance and a reimbursement for expenses incurred in using a motor vehicle, the allowance will be considered to be unreasonable and will accordingly be included in income. This rule does not apply where the reimbursement is for charges for parking or certain other expenses. New subsection 6(1.1) of the Act provides that amounts in respect of the use of a motor vehicle do not include amounts related to the parking of the vehicle. Accordingly, the reference to reimbursements for parking expenses in subparagraph 6(1)(b)(xi) is superfluous and is repealed. This amendment applies to 1993 and subsequent taxation years.

Subclause 2(3)

ITA
6(1)(k)

Where an employer or a person related to the employer pays for automobile operating expenses relating to the personal use of an automobile by an employee, the payment of these expenses represents a taxable benefit to the employee under new paragraph 6(1)(k) or (l) of the Act. Automobile operating expenses include gasoline, insurance and maintenance costs. However, parking costs are not considered to be an operating expense and any benefit related to parking is included in income under paragraph 6(1)(a) of the Act.

New paragraph 6(1)(k), which applies to 1993 and subsequent taxation years, provides a formula for determining the operating expenses benefit of an employee where an automobile is provided to the employee or a person related to the employee by the employer or a person related to the employer and operating expenses are paid by the employer or a person related to the employer ("the payor"). Thus this paragraph applies where a person related to the employer provides an automobile to the employee and another person related to the employer pays for automobile operating expenses.

If such an automobile is used primarily in the course of the employee's office or employment, the employee can elect that the operating expenses benefit be one-half of the standby charge for the automobile determined under subparagraph 6(1)(e)(i) of the Act less any reimbursements to the payor in respect of operating expenses. The employee must, however, inform the employer in writing by the end of a year of the employee's intention to have this election apply for that year.

Where the employee is not eligible to make, or does not make, the above election, the amount of the benefit in respect of the operation of an automobile is determined by reference to the number of kilometres driven for personal use during the period in the year in which the automobile is made available by the employer or a person related to the employer. For 1993 and subsequent taxation years, the automobile operating expenses benefit of such an employee shall be determined as 12 cents for every such kilometre driven, less any reimbursements to the payor in respect of operating expenses.

In order to be taken into account in calculating the operating expenses benefit for a year, any reimbursements to the payor must be made within 45 days after the end of the year. Further, the resulting income inclusion is considered to already include the GST component and no further income inclusion is required under paragraph 6(1)(e.1) of the Act.

No benefit will be imputed where the employee fully reimburses the payor for all operating expenses attributable to personal use within 45 days after the end of the year. A full reimbursement is considered to have been made only where the employee pays back the portion of all operating expenses (including GST) paid or payable by the payor, attributable to personal use whether or not the payor is entitled to an input tax credit or rebate of GST for these expenses.

ITA
6(1)(l)

New paragraph 6(1)(l) of the Act, which applies to 1993 and subsequent taxation years, includes in income the value of any benefit received by an employee for automobile operating expenses attributable to personal use. This paragraph applies where an employee receives a payment (other than an allowance included in income under paragraph 6(1)(b)) for operating expenses of his or her own automobile because of his or her employment or office. It also applies where an employee of a partner in a partnership receives a payment from the partnership for operating expenses of an automobile provided by the partner. However, where paragraph 6(1)(k) applies, or where that paragraph would have applied in respect of the operating expenses if an employee had not made a full reimbursement of the operating expenses, no benefit is determined under this paragraph.

Unlike other benefits included in income under paragraph 6(1)(a) of the Act, the value of this benefit is determined using GST-included operating expenses whether or not the person or partnership that conferred this benefit can claim an input tax credit or rebate of GST for these expenses.

Subclause 2(4)

ITA
6(1.1)

Subsection 6(1.1) of the Act, which applies to 1993 and subsequent taxation years, clarifies that any benefit related to parking is not considered to be a benefit in respect of the use (which includes the operation) of a motor vehicle. Thus, any benefit related to parking will be included in the income of the benefit recipient under paragraph 6(1)(a). In calculating this benefit for the purpose of this paragraph, the GST portion of the parking costs is excluded because of subsection 6(7) of the Act. The GST portion of such an expenditure is included in income under paragraph 6(1)(e.1).

Subclause 2(5)

ITA
6(2.2)

Subsection 6(2.2) of the Act is repealed for 1993 and subsequent taxation years as a consequence of the introduction of new paragraph 6(1)(k) of the Act. The election to use one-half of the standby charge for an employer-provided automobile as the benefit for employer-paid operating costs of the automobile is now incorporated in new paragraph 6(1)(k).

Clause 3

Employee Stock Options

ITA
7(1.5)

Subsection 7(1) of the Act provides for the inclusion of stock option benefits in employment income. The benefit is included in the employee's income at the time the employee exercises the option and is measured as the excess of the fair market value of the shares at that time over the price paid for them. Subsection 7(1.1) of the Act provides that, in the case of shares of the capital stock of a Canadian-controlled private corporation issued under an employee stock option plan, the employment benefit determined under paragraph 7(1)(a) is, under certain conditions, to be included in the employee's income only in the taxation year in which the employee disposes of or exchanges the shares.

Pursuant to paragraph 110(1)(d.1) of the Act, an amount equal to one quarter of the amount of the benefit deemed to have been received is deductible where the taxpayer disposed of a share acquired after May 22, 1985 as a result of exercising a stock option granted by a Canadian-controlled private corporation and the share has not been disposed of or exchanged, otherwise than as a consequence of a death, within two years from the date of acquisition.

Subsection 7(1.5) of the Act provides that certain share dispositions or exchanges will not be considered dispositions or exchanges in certain circumstances for the purposes of the rules in subsection 7(1.1) and paragraph 110(1)(d.1). Subsection 7(1.5) of the Act is amended, applicable to the 1992 and subsequent taxation years, to ensure that it applies for multiple share exchanges.

Clause 4

Deductions From Employment Income

ITA
8

Section 8 of the Act provides for the deduction of various amounts in computing income from an office or employment.

Subclauses 4(1) and (2)

ITA
8(1)(m.2)

Paragraph 8(1)(m.2) of the Act allows a deduction in computing income from an office or employment in respect of qualifying member contributions made to a pension plan that is a retirement compensation arrangement (RCA) with a custodian resident in Canada. Contributions made to a prescribed plan or arrangement are considered to be qualifying contributions for this purpose.

These amendments to paragraph 8(1)(m.2), which apply to 1992 and subsequent taxation years, permit a deduction for employee pension plan contributions if

(i) the contributions are qualifying contributions and the plan is an RCA with a custodian resident in Canada, or

(ii) the contributions are made to a prescribed pension plan established by the federal or a provincial government.

Subclause 4(3)

ITA
8(1)(o.1)

New paragraph 8(1)(o.1) provides that amounts deductible under amended subsection 144(9) of the Act, relating to forfeitures under an employees profit sharing plan, may be deducted in computing an individual's income from an office or employment. This treatment is parallel to paragraph 6(1)(d) of the Act, under which allocations under employees profit sharing plans are included in computing an individual's income from an office or employment.

This amendment applies to the 1992 and subsequent taxation years.

Clause 5

Taxation Years of Proprietorships

ITA
11(2)

Subsection 11(2) of the Act provides that, with respect to businesses of proprietors having fiscal periods that do not coincide with the calendar year, a reference to "taxation year" or "year" shall be read as a reference to a fiscal period of the business ending in the calendar year.

Subsection 11(2) is amended to clarify that this fiscal period treatment of business income of a proprietor does not apply to capital gains or capital losses of the proprietor, even though the capital property that gave rise to the gain or loss may have been used in the proprietor's business.

Accordingly, while subsection 11(2) applies to section 80.3 of the Act, which provides for a deferral to a subsequent taxation year for income received in the year from the forced destruction of livestock or drought-induced sales of breeding livestock herds, capital gains or capital losses of a proprietor are to be computed on a calendar year basis.

This amendment applies to the 1988 and subsequent taxation years.

Clause 6

Income From Business or Property

ITA
12

Section 12 of the Act requires the inclusion of various amounts in computing the income of a taxpayer for a year from a business or property.

Subclause 6(1)

ITA
12(1)(m)

Paragraph 12(1)(m) of the Act requires a taxpayer's income from a trust or estate to be included in computing the taxpayer's income from a business or property.

Paragraph 12(1)(m) of the Act is amended to clarify that amounts included in computing a taxpayer's income under subsection 132.1(1) of the Act are to be included in computing the taxpayer's income from a business or property. Subsection 132.1(1) provides that a mutual fund trust may designate a specified amount for its taxation year in respect of a trust unit, which generally results in a deduction of the specified amount in computing the income of the trust and a corresponding income inclusion for the taxpayer owning the unit during the year.

This amendment applies to the 1988 and subsequent taxation years.

Subclause 6(2)

ITA
12(3)

Subsection 12(3) of the Act requires corporations, partnerships and certain trusts to use the accrual method for computing interest income in respect of debt obligations. Certain debt obligations are excluded from this accrual rule. Subsection 12(3) is amended to also exclude indexed debt obligations issued after October 16, 1991. Interest in respect of indexed obligations will be included in income by paragraph 12(1)(c) or subsection 16(6) of the Act.

Subclause 6(3)

ITA
12(11)

"investment contract"

Subsection 12(11) of the Act contains a definition of the term "investment contract" for the purposes of the rule in subsection 12(4) requiring the periodic reporting of accrued interest. This definition is amended, with respect to debt obligations issued after October 16, 1991, to exclude indexed debt obligations. Interest in respect of indexed obligations will be included in income by paragraph 12(1)(c) or subsection 16(6) of the Act.

Clause 7

Depreciable Property

ITA
13

Section 13 provides a number of special rules relating to the tax treatment of depreciable property. Generally, these rules apply for the purposes of sections 13 and 20 of the Act and the capital cost allowance regulations.

Subclauses 7(1) and (2)

ITA
13(7)

Subsection 13(7) of the Act provides rules relating to capital cost that apply where there has been a change of use of depreciable property, where depreciable property is used partly for gaining or producing income and partly for some other purpose, and where depreciable property is transferred between persons not dealing at arm's length.

The preambles to subsection 13(7) and paragraph 13(7)(e) of the Act are amended to ensure that the adjustments provided therein are subject to new subsection 70(13) of the Act. Generally, new subsection 70(13) provides that certain adjustments made to the capital cost of depreciable property of a prescribed class do not apply for the purposes of section 70, and, where a provision of section 70 (other than subsection (13)) applies, for the purposes of sections 13 and 20 (but not for the purposes of any regulations made for the purpose of paragraph 20(1)(a)).

These amendments apply after 1992.

Subclause 7(3)

ITA
13(33)

New subsection 13(33) of the Act provides that, for greater certainty, where depreciable property is acquired for consideration that includes the transfer of another property (for example, a trade-in), the portion of the cost of the depreciable property that is reflective of the transferred property shall not exceed the fair market value of the property so transferred. This new subsection applies to depreciable property acquired after November 1992.

Clause 8

Eligible Capital Property

ITA
14(8)

Subsection 14(1) of the Act provides that where, at the end of a taxation year, the amounts required to be deducted from a taxpayer's cumulative eligible capital exceed the amounts required to be added to that amount, the excess (referred to as the "negative balance" for the purposes of this commentary) must be included in the taxpayer's income for the year as business income or as a taxable capital gain.

Subparagraph 14(1)(a)(v) of the Act provides that, in the case of a taxpayer that is an individual who was resident in Canada throughout the year, the amount of the negative balance in excess of the portion that relates to the recapture of previous deductions taken under paragraph 20(l)(b) of the Act in respect of eligible capital property is deemed to be a taxable capital gain of the individual from the disposition of property and is, therefore, eligible for the lifetime capital gains exemption.

This amendment adds new subsection 14(8) to the Act which is a special relieving provision aimed at individuals who either become, or cease to be, resident in Canada during a taxation year. New subsection 14(8) of the Act provides that, for the purposes of subsection 14(1), an individual who was resident in Canada at any time in a particular year will be treated as being resident in Canada throughout the year if the individual was a resident of Canada throughout either the immediately preceding or immediately following taxation year.

New subsection 14(8) of the Act applies to the 1988 and subsequent taxation years.

Clause 9

Shareholder Benefits

ITA
15

Section 15 of the Act requires the inclusion of certain benefits received or enjoyed by a shareholder of a corporation.

Subclause 9(1)

ITA
15(1)

Subsection 15(1) of the Act requires a shareholder of a corporation to include in income the amount or value of certain benefits conferred on the shareholder by the corporation. Paragraph 15(1)(c) excludes from subsection 15(1) any benefit that may arise where a corporation confers on all the owners of the common shares of the corporation rights to acquire additional shares of the corporation. This exclusion is limited to situations where the right conferred in respect of each common share is identical to the right conferred in respect of all other common shares.

This amendment adds a rule to paragraph 15(1)(c) to provide that two classes of common shares are considered to be identical property where different voting rights are attached to each class but there are no other differences in their terms that could cause a material difference between the fair market values of shares of the two classes. This ensures that a corporation with voting and non-voting common shares is able to confer on shareholders of each class a right to acquire additional shares of that class without a shareholder benefit arising.

This amendment applies to benefits conferred after December 19, 1991.

Subclause 9(2)

ITA
15(1.4)

Subsection 15(1.4) of the Act provides that, where subsection 15(1) requires the value of a benefit to be included in computing the income of a shareholder in respect of a supply (other than a zero-rated supply or an exempt supply) of a property or service that is taxable under GST, the taxpayer must also include in income an amount equal to 7 per cent of the amount of the benefit. This generally results in the shareholder being required to include in income the GST that would have been payable in respect of the benefit had the property or service been purchased in the marketplace.

Subsection 15(1.4) is amended, applicable to 1993 and subsequent taxation years, to provide that there is no GST inclusion under that subsection with respect to automobile benefits. The GST relating to a shareholder's automobile benefit is calculated in accordance with section 6 of the Act, as modified by subsection 15(5), and is included in the shareholder's income under subsection 15(1).

Subclause 9(3)

ITA
15(5)

Subsection 15(5) of the Act provides rules relating to shareholder benefits from the use by a shareholder of a corporation of the corporation's automobile. Subsection 15(5) is amended consequential on the introduction of new paragraphs 6(1)(k) and (l) and subsection 6(1.1) as well as the repeal of subsection 6(2.2). Thus shareholders' automobile benefits will continue to be calculated generally in the same way as the automobile benefits received by an employee who uses an employer-provided automobile. This amendment applies to 1993 and subsequent taxation years.

Clause 10

Obligation Issued at Discount

ITA
16(3)

Subsection 16(3) of the Act provides rules relating to the taxation of deep discount debt obligations issued by persons that are not subject to tax under Part I of the Act. Under this subsection, the difference between the principal amount of such a debt obligation and its issue price (i.e., the discount) is included in the income of the first Canadian resident to acquire the obligation who is not exempt from tax under Part I. The object of this rule is to prevent taxpayers from converting amounts that are substitutes for interest into capital gains. Subsection 16(3) is amended to provide that it will apply only to the first taxpayer that acquires a particular obligation as a capital property. This amendment is applicable to the 1990 and subsequent taxation years.

Clause 11

Prohibited Deductions – Business and Property Income

ITA
18

Section 18 of the Act prohibits the deduction of certain outlays and expenses in computing a taxpayer's income from a business or property.

Subclause 11(1)

ITA
18(3.1)(a)

Subsection 18(3.1) of the Act denies the immediate deduction of certain costs, generally referred to as construction period soft-costs, relating to the construction, renovation or alteration of a building. These costs are required to be added to the capital cost of the building to which they relate and may be deducted at the rate allowed in respect of the class of depreciable property in which the building is included.

This amendment to paragraph 18(3.1)(a), which applies after 1990, corrects a cross-reference that is necessitated by the introduction of paragraph 20(1)(qq) and the repeal of former paragraph 20(1)(gg) by the *Statutes of Canada*, 1993, chapter 24 (Bill C-92).

Subclause 11(2)

ITA
18(10)

Paragraph 18(1)(o) of the Act prohibits the deduction of employer contributions to employee benefit plans (EBPs). Subsection 18(10) exempts certain contributions from this prohibition. In particular, a contribution is exempted where the following conditions are satisfied:

- the custodian of the EBP is a non-resident,

- the contribution is made in respect of a non-resident employee or an employee who has resided in Canada for no more than 36 of the preceding 72 months and who was a member of the EBP before becoming a Canadian resident, and

- the contribution is not in respect of services performed or to be performed in any period, other than the preceding 72 months, when the employee is resident in Canada.

The exemption would apply, for example, with respect to contributions to a foreign pension plan on behalf of an employee who was a member of the pension plan before transferring to Canada. Employer contributions will be deductible for the first 36 months after the employee becomes a Canadian resident.

A similar exemption applies for the purpose of the special retirement compensation arrangement (RCA) rules in subsection 207.6(5) of the Act which apply with respect to foreign pension plans. This exemption applies for contributions made in respect of services rendered during the first 60 months of an employee becoming a resident.

Several amendments are made to the exemption which subsection 18(10) provides for contributions to a foreign EBP in respect of Canadian-resident employees. First, the period for which an exemption is provided is extended to 60 months after an employee becomes a Canadian resident. This will provide consistency with the RCA rules. Second, the manner in which the period of residency is to be measured is clarified. The third change is to expand the scope of the exclusion so that it also applies where an employee is not a member of the EBP before becoming a Canadian resident, but joins the plan by the end of the calendar month following the month in which he or she becomes a resident. Lastly, a rule is added to provide that where an employee's benefits under one EBP are replaced by benefits under another EBP, the replacement EBP is considered (with respect to that employee) to be the same plan as the first EBP. Without this rule, subsection 18(10) would not apply with respect to contributions to the replacement plan, since the employee would not have been a member of that plan at the relevant time.

The amendments to subsection 18(10) apply to contributions made after 1992.

Subclause 11(3)
ITA
18(11)

Paragraphs 20(1)(c), (d), (e), (e.1) and (f) of the Act permit deductions for interest and certain other financing expenses relating to borrowed money used by a taxpayer for the purpose of earning income from a business or property. These provisions are, however, subject to subsection 18(11) of the Act which prohibits the deduction of such expenses in respect of indebtedness incurred for the purposes of making a contribution to an RRSP or certain other deferred income plans.

Subsection 18(11) is amended to prohibit the deduction of interest in respect of indebtedness incurred for the purposes of making a contribution to any account under a prescribed provincial pension plan (i.e., the Saskatchewan Pension Plan). This amendment applies to the 1993 and subsequent taxation years.

Clause 12

Deductions in Computing Income From Business or Property

ITA
20

Section 20 of the Act provides rules relating to the deductibility of certain outlays, expenses and other amounts in computing a taxpayer's income for a taxation year from a business or property.

Subclauses 12(1) and (2)

ITA
20(1)(e)

Paragraph 20(1)(e) of the Act provides for the deduction over a five-year period of expenses incurred in issuing securities or in borrowing money. These expenses are deductible in equal portions over the five-year period starting with the year in which the expenses are incurred. If there is a short taxation year, the otherwise deductible portion is subject to a pro-rata adjustment. As well, if the borrowing for which the expenses were incurred is repaid in a year, the undeducted balance of the expenses will be deductible in that year.

Paragraph 20(1)(e) is amended to allow for the similar deduction of expenses incurred after 1987 in the course of becoming indebted by reason of an amount having become payable by the taxpayer for property acquired to earn income (other than property the income from which is exempt or property that is a life insurance policy). The amendment also allows for the deduction of expenses incurred in the rescheduling or restructuring of a debt obligation or in the assumption of a debt obligation where the debt obligation arises from borrowings used for the purpose of earning business income or is in respect of an amount payable for property (other than property the income from which is exempt or property that is a life insurance policy) acquired for the purpose of earning income. In the case of a rescheduling or restructuring, the rescheduling or restructuring must provide for either the modification of the terms or conditions of the debt obligation or the conversion or substitution of the debt obligation to or for a share or another debt obligation.

Subparagraph 20(1)(e)(v) of the Act is amended as a consequence of these changes, to include a reference to debt obligations in respect of amounts payable for property acquired for the purpose of earning income.

Subclause 12(3)

ITA
20(1)(e.1)

Paragraph 20(1)(e.1) of the Act provides that, notwithstanding paragraph 20(1)(e), certain financing expenses that relate only to the year they are incurred are deductible in that year. This paragraph is amended to provide a similar deduction for such expenses incurred, after 1987, in respect of an amount payable for property acquired to earn business income, or the rescheduling, restructuring or assumption of a debt obligation.

Subclause 12(4)

ITA
20(1)(ll)

Paragraph 20(1)(ll) of the Act allows a deduction in computing income from a business or property for interest on a tax refund that a taxpayer is required to repay because the refund was excessive. New provisions for the payment of interest on allowable refunds of non-resident-owned investment corporations, dividend refunds and capital gains refunds were added to the Act by the *Statutes of Canada*, 1993, chapter 24 (Bill C-92). Those new provisions require refund interest to be repaid on any portion of the refund that is later found to be excessive. This amendment to paragraph 20(1)(ll), which applies to taxation years beginning after 1991, allows a deduction for any such refund interest that is required to be repaid, in the same way that a deduction is allowed for interest required to be repaid in respect of excessive tax refunds.

Subclause 12(5)

ITA
20(1)(rr)

Paragraph 20(1)(rr) of the Act provides for the deduction of costs relating to prescribed devices or equipment acquired primarily to assist individuals who have a sight or hearing impairment. This amendment, which applies to amounts paid after February 25, 1992, ensures that devices and equipment to assist individuals who have other types of impairments (for example mobility impairments) are also eligible for the same tax treatment.

Subclause 12(6)

ITA
20(3)

Subsection 20(3) of the Act ensures continuity of purpose in respect of money borrowed to repay money previously borrowed. Where a taxpayer uses borrowed money to repay money previously borrowed, or to repay an amount for previously acquired property described in subparagraph 20(1)(c)(ii), the borrowed money will be treated, for the purposes of section 21 and paragraphs 20(1)(c) and (k), as having been used for the same purposes as the original borrowing, or as having been used to acquire the same property, as the case may be.

Subsection 20(3) is amended to add references to paragraphs 20(1)(e) and (e.1) of the Act which deal with the treatment of certain refinancing fees. This amendment applies to expenses incurred after 1987.

Subsection 20(3) is also amended to add references to new subsections 20.1(1) and (2), which contain rules relating to the deduction of interest on borrowed money, and on amounts payable for property, after a loss of source of income. A further amendment makes the application of subsection 20(3) subject to new subsection 20.1(6) which provides that subsection 20.1(2) applies instead of subsection 20(3) to refinancings of amounts to which subsection 20.1(2) has applied. These amendments apply with respect to the deduction of interest incurred after 1993.

Clause 13

Loss of Source of Income

ITA
20.1

Interest on borrowed money is deductible under paragraph 20(1)(c) of the Act (subject to restrictions in some situations) where the borrowed money is used for the purpose of earning income from a business or property. As the courts have confirmed, interest ceases to be deductible under paragraph 20(1)(c) when the source of income to which the interest relates no longer exists and the borrowed money cannot be traced to another income-producing source.

New section 20.1 of the Act contains rules that apply where, because of a loss of source of income, borrowed money ceases to be used for an income-earning purpose. The rules ensure that interest on such borrowed money will, in certain circumstances, continue to be deductible under paragraph 20(1)(c). Section 20.1 is also applicable with respect to amounts payable for property acquired for an income-earning purpose. These new rules apply where the loss of source of income occurs after 1993.

Borrowed money used to earn income from property

ITA
20.1(1)

New subsection 20.1(1) of the Act applies where a taxpayer who has used borrowed money for the purpose of earning income from a capital property, other than real property or depreciable property, ceases to use the money for that purpose after 1993 and a portion of the borrowed money has been lost because of a decline in the value of the property. The portion of the borrowed money that has been lost is deemed to continue to be used for the purpose of earning income from the property. Consequently, that portion of the borrowed money will satisfy the use test in subparagraph 20(1)(c)(i) of the Act, and the property will continue to be considered a source of income of the taxpayer even though the taxpayer may have disposed of it. Thus, the taxpayer will be able to deduct interest on the portion of the borrowed money that has been lost (assuming none of the rules in the Act restricting the deduction of interest is applicable).

Generally, borrowed money will cease to be used for the purpose of earning income from a property when the taxpayer sells or otherwise disposes of the property. However, in some circumstances, borrowed money may cease to be so used while the taxpayer still owns the property – for example, where a taxpayer has used borrowed money to acquire shares of a corporation that has subsequently become bankrupt.

The amount of borrowed money to which subsection 20.1(1) applies is determined under paragraph 20.1(1)(b) as the total amount of borrowed money outstanding just before it ceases to be used to earn income from the property **minus** the amount of borrowed money that is not considered to have been lost determined as follows:

- where the taxpayer has disposed of the property for an amount of consideration at least equal to the fair market value of the property, the amount of the borrowed money that, under the existing rules, is traceable to the consideration, and

- otherwise, the amount of the borrowed money that would, under the existing rules, be traceable to the money received by the taxpayer if the taxpayer had disposed of the property for an amount of money equal to the fair market value of the property.

Where the taxpayer disposes of the property to the creditor in return for a reduction in the amount owed, the amount of the reduction is subtracted in determining the amount of borrowed money to which subsection 20.1(1) applies. (Note that subparagraph 20.1(1)(b)(i) would not apply with respect to a reduction, since the reduction would not be consideration to which the borrowed money is traceable.) This is relevant in the unusual situation where consideration includes both money (or other property) and a reduction in the amount owed. Furthermore, if the amount of the consideration is less than the fair market value of the property, the amount of the reduction in the debt is subtracted from the fair market value for the purpose of determining the amount of money that the taxpayer is considered to have received on the disposition of the property.

Where a taxpayer has borrowed money under more than one debt obligation for the purpose of acquiring a property, subsection 20.1(1) applies with respect to the total amount of borrowed money that was being used to earn income from the property.

A related amendment is being made to subsection 20(3) of the Act, to extend its application to subsection 20.1(1). Thus, borrowed money to which subsection 20.1(1) applies may be borrowed money that was, in fact, used to repay previously borrowed money but that has been deemed by subsection 20(3) to be used for the purpose of earning income from property. It should also be noted that once subsection 20.1(1) has applied to deem borrowed money to continue to be used for the purpose of earning income from property, money subsequently borrowed to refinance the previous borrowing will be deemed by subsection 20(3) to be used for the same purpose.

EXAMPLE 1

A taxpayer borrowed $1,000 in 1992 to acquire shares of Corporation A at a cost of $1,600. The shares are such that the borrowed money is considered to be used for the purpose of earning income from property. The shares subsequently decline in value, and are sold by the taxpayer in 1994 for $900 (which is their fair market value). The taxpayer then invests the $900 in income-producing shares of Corporation B. None of the restrictions in the Act on the deduction of interest is applicable.

Result:

1. Since the taxpayer sold the shares of Corporation A for 9/16 of their cost, the amount of the original $1,000 of borrowed money that is considered to have been used to acquire the shares of Corporation B is $563 (= 9/16 x $1,000). Subsection 20.1(1) applies to deem the other $437 of the borrowed money to continue to be used for the purpose of earning income from the shares of Corporation A. Thus, the taxpayer can continue to deduct interest in respect of this borrowed money under subparagraph 20(1)(c)(i). By virtue of subsection 20(3), if the taxpayer borrows money to repay the $437, interest on the subsequently borrowed money will also be deductible.
2. The existing rules apply with respect to interest on the $563 that can be traced to the shares of Corporation B. Since this money is used for an income-earning purpose, interest on it is deductible under subparagraph 20(1)(c)(i).

EXAMPLE 2

Same facts as in example 1, except that the taxpayer uses the $900 proceeds from the sale of the shares of Corporation A for personal expenditures.

Result:

1. Interest on $437 of the borrowed money is deductible after the shares are sold, for the reasons given in example 1.

2. Interest on the $563 that is traceable to the personal expenditures is not deductible, since that portion of the borrowed money is not used for an income-earning purpose.

EXAMPLE 3

Same facts as in example 1, except that instead of selling the shares of Corporation A the taxpayer gives them to a child of the taxpayer.

Result:

1. To determine the amount of the borrowed money to which subsection 20.1(1) applies, it is necessary to determine how much of the borrowed money would be traceable to the proceeds if the taxpayer sold the shares for their fair market value. As in example 1, $563 would be so traceable. Thus, subsection 20.1(1) deems the remaining $437 of the borrowed money to continue to be used for the purpose of earning income from the shares of Corporation A, with the result that interest on this amount is still deductible.

2. Interest on the $563 is not deductible, since that amount is traceable to the shares that were given away.

Borrowed money used to earn income from business

ITA
20.1(2)

New subsection 20.1(2) of the Act applies where a taxpayer who has used borrowed money for the purpose of earning income from a business ceases, after 1993, to carry on the business. The subsection contains three rules relating to the determination of the use of the borrowed money after the business has ceased:

- Paragraph 20.1(2)(a) – Where the taxpayer holds property that was used in the business just before its cessation, a portion of the borrowed money is deemed to have been used to acquire each such property. This deemed use rule applies with respect to a particular property immediately before the taxpayer disposes of it, and the amount of borrowed money that is deemed to have been used to acquire the property is equal to the fair market value of the property at its date of disposition. (This deemed use rule is discussed in more detail below.)

- Paragraph 20.1(2)(b) – The borrowed money is to be considered to have been used to acquire the property remaining at the cessation of the business only to the extent provided by the rule in paragraph 20.1(2)(a). Thus, the deemed use rule replaces any factual tracing of the borrowed money that might otherwise occur.

- Paragraph 20.1(2)(c) – The portion of the borrowed money that is not deemed to have been used before a particular time to acquire property is deemed to continue to be used at that time for the purpose of earning income from the business.

The portion of the borrowed money that is deemed by paragraph 20.1(2)(c) to be used in the business will satisfy the use test in subparagraph 20(1)(c)(i) of the Act, and the business will continue to be considered a source of income of the taxpayer even though the business is no longer carried on. Thus, the taxpayer will be able to deduct interest on this portion of the borrowed money. In this regard, paragraph 20.1(2)(d) provides that the business is considered to have ongoing fiscal periods that coincide with the taxation years of the taxpayer, with the first such fiscal period starting at the end of the last actual fiscal period of the business.

After paragraph 20.1(2)(a) deems a part of the borrowed money to have been used to acquire a property, the existing rules will apply to determine the use of that part, and thus the deductibility of the interest on that part. For example, if a property is sold and the proceeds used for a personal purpose, interest on the amount of the borrowed money that has been matched with that property will cease to be deductible.

As indicated above, the rule in paragraph 20.1(2)(a) that matches borrowed money with properties applies each time there is a disposition of a property. The amount of borrowed money matched with a particular property is the lesser of the fair market value at the time of disposition of the property and the amount of borrowed money outstanding at that time that has not been matched with any other property. This rule applies without regard to the actual use of borrowed money. For example, if all the money was borrowed to acquire real property and the taxpayer first disposes of a vehicle that was used in the business, a portion of the borrowed money will be considered to have been used to acquire the vehicle.

The following points concerning the application of paragraph 20.1(2)(a) should be noted:

- The deemed disposition rules in new subsection 20.1(3) provide that a taxpayer is considered to dispose of property where there is a change in use of the property. For more information, see the commentary on that subsection.

- Where a taxpayer disposes of two or more properties at the same time and the amount of borrowed money still to be matched with properties is less than the fair market value of those properties, the taxpayer may choose the properties to which the remaining borrowed money is matched.

- Where borrowed money is owed under two or more debt obligations, the taxpayer may determine the amount of borrowed money under each obligation that is to be matched with property.

A related amendment is being made to subsection 20(3) of the Act, to extend its application to subsection 20.1(2). Thus, borrowed money to which subsection 20.1(2) applies may be borrowed money that was, in fact, used to repay previously borrowed money but that has been deemed by subsection 20(3) to be used for the purpose of earning income from the business. It should also be noted that once paragraph 20.1(2)(a) has applied to match borrowed money with a property, the current use of that money will determine the use of borrowed money used to repay that money, pursuant to subsection 20(3). Subsection 20(3) will not apply, however, with respect to the refinancing of borrowed money that is deemed by paragraph 20.1(2)(c) to be used for the purpose of earning income from a business. New subsection 20.1(6) provides that paragraphs 20.1(2)(a) to (c) apply, instead of subsection 20(3), to such refinancings.

EXAMPLE

On July 1, 1994 an individual ceases to carry on an unsuccessful business. At that time, the individual owes $50,000 in respect of borrowed money used in the business. The residual business property is not used while the individual arranges for its sale. The individual sells the property on October 1, 1994 to an arm's length buyer for $20,000, and uses the proceeds for personal expenditures. The individual subsequently repays the $50,000 on July 1, 1995.

Result:

1. Paragraph 20.1(2)(c) deems the full $50,000 to continue to be used, in the period from July 1, 1994 to October 1, 1994, for the purpose of earning income from the business. Thus, interest on the borrowed money for this period is deductible under subparagraph 20(1)(c)(i).

2. Paragraph 20.1(2)(a) deems $20,000 of the borrowed money to have been used to acquire the property immediately before its disposition on October 1, 1994. Since the proceeds are used for personal purposes, the $20,000 is no longer considered to be used for an income-earning purpose. Hence, interest on that amount of the borrowed money ceases to be deductible.

3. From October 1, 1994 to July 1, 1995, paragraph 20.1(2)(c) deems $30,000 of the borrowed money to continue to be used for the purpose of earning income from the business, and so interest on this amount continues to be deductible.

Deemed dispositions

ITA
20.1(3)

Paragraph 20.1(2)(a) of the Act provides that where borrowed money has ceased to be used in a business because of the termination of the business, the money is considered to have been used to acquire each property remaining in the business. This deemed use rule applies with respect to a particular property just before the disposition of the property. New subsection 20.1(3) contains deemed disposition rules for this purpose.

Paragraph 20.1(3)(a) of the Act provides that a property that was used in the terminated business is considered to be disposed of when the taxpayer begins to use the property in another business or for any other purpose. For example, assume a taxpayer owns a building that was used in a business the taxpayer has ceased to carry on. For one year following the termination of the business, the taxpayer does not use the building for any income-earning or personal purpose. Then the taxpayer begins to use the building in a new business. Paragraph 20.1(3)(a) will deem the building to have been disposed of, for the purpose of paragraph 20.1(2)(a), at the end of the one-year period. Consequently, paragraph 20.1(2)(a) will apply at that time if there is any borrowed money remaining to be matched with the property of the terminated business.

Paragraph 20.1(3)(b) of the Act applies where a property was used in part in the terminated business and in part for another purpose. Such property is deemed to have been disposed of at the termination of the business, and its fair market value at that time is deemed to equal the proportion of its total fair market value that the use regularly made of the property in the business is of the whole use of the property. (The fair market value is relevant because the amount of borrowed money that paragraph 20.1(2)(a) deems to have been used to acquire the property depends on the fair market value of the property.)

Paragraph 20.1(3)(b) would apply, for example, where a taxpayer has used a vehicle in part in a business and in part for personal use. Assume that the business use was 60% of total use and that the fair market value of the vehicle on the termination of the business was $10,000. For the purpose of paragraph 20.1(2)(a), the taxpayer will be considered to have disposed of the vehicle when the business terminated, and the fair market value of the vehicle will be considered to be $6,000. Thus, that amount of borrowed money will be considered to have been used to acquire the vehicle immediately before the termination of the business.

Paragraph 20.1(3)(c) provides that the deemed disposition rules for trusts in subsections 104(4) to (5.2) of the Act do not apply with respect to the application of paragraph 20.1(2)(a) to a trust that has ceased to carry on a business.

Amount payable for property

ITA
20.1(4)

New subsection 20.1(4) of the Act extends the loss of source rules for borrowed money in subsections 20.1(1) and (2) to amounts described in subparagraph 20(1)(c)(ii) of the Act – that is, to amounts payable for property acquired for the purpose of earning income from the property or from a business. It does this by deeming an amount that is payable by a taxpayer for property to be payable on account of borrowed money used by the taxpayer to acquire the property. Subsection 20.1(1) and paragraph 20.1(2)(c) can therefore apply to deem an income-earning purpose to continue with respect to such amounts, and paragraph 20.1(2)(a) can apply to match the amounts with the property remaining on the termination of a business.

Where subsection 20.1(2) applies with respect to an amount payable for property, paragraph 20.1(2)(b) has the effect of deeming the amount not to be payable for property. Consequently, subparagraph 20(1)(c)(ii) will not provide a deduction for interest on the amount. To enable interest to continue to be deducted once subsection 20.1(2) applies with respect to an amount payable for property, and to ensure the continued application of other rules to the amount, subsection 20.1(4) provides that the amount is considered for all purposes of the Act to be payable on account of borrowed money.

The discussion in the commentary on subsections 20.1(1), (2) and (6) of borrowed money used for refinancing is also relevant where borrowed money is used to pay an amount payable for property. In this regard, subsection 20.1(4) applies for the purpose of the refinancing rule in subsection 20.1(6).

Interest in partnership

ITA
20.1(5)

New subsection 20.1(5) of the Act applies where a taxpayer has used borrowed money to acquire an interest in a partnership. Since a partnership is not a separate legal person, the borrowed money may be considered for the purposes of the Act to be used for the purpose of earning income from the business or property of the partnership rather than for the purpose of earning income from property that is the partnership interest. Subsection 20.1(5) provides that, in this case, the borrowed money is to be considered to be used for the purpose of earning income from the partnership interest. Consequently, section 20.1 will apply in the same way to borrowed money used to acquire a partnership interest as it applies to borrowed money used to acquire shares in a corporation.

Refinancings

ITA
20.1(6)

New subsection 20.1(6) of the Act applies where a taxpayer borrows money to repay previously borrowed money that paragraph 20.1(2)(c) deems to be used to earn income from a terminated business. Subsection 20.1(6) provides that paragraphs 20.1(2)(a) to (c) apply with respect to the newly borrowed money. Consequently, until such time as the money is deemed to have been used to acquire properties of the terminated business, the money is considered to be used to earn income from the business. These rules apply in place of the deemed use rule in subsection 20(3) of the Act. (As noted in the discussion of new subsection 20.1(2), subsection 20(3) will apply to determine the use of borrowed money used to repay borrowed money that is deemed by paragraph 20.1(2)(a) to have been used to acquire properties of a terminated business.)

Subsection 20.1(6) also applies, by virtue of subsection 20.1(4), with respect to borrowed money that is used to pay an amount payable for property, where the amount is deemed by paragraph 20.1(2)(c) to be used to earn income from a terminated business.

Clause 14

Capital Gains and Losses

ITA
39(9) and (10)

Section 39 of the Act sets out the meaning of capital gain, capital loss and business investment loss and provides a number of special rules relating to capital gains.

In determining a business investment loss, a taxpayer is required to deduct from the amount of the business investment loss otherwise determined, the lesser of the amount of the business investment loss and the taxpayer's net capital gains for which a deduction was claimed under section 110.6 of the Act, to the extent that such gains have not been used to reduce other business investment losses. In calculating the net capital gains for which a deduction was claimed under section 110.6 of the Act, deductions taken under section 110.6 for taxable capital gains are grossed up by the applicable inclusion rate. These amendments to subsections 39(9) and (10) of the Act, which apply to the 1988 and subsequent taxation years, adjust the applicable inclusion rate for deemed capital gains included in income under subparagraph 14(1)(a)(v) of the Act.

Clause 15

Capital Gains – Special Rules

ITA
40(2)(i)(ii)

Paragraph 40(2)(i) of the Act requires that a capital loss on the disposition of shares of a prescribed venture capital corporation, a prescribed labour-sponsored venture capital corporation or shares of a taxable Canadian corporation that were held in a prescribed stock savings plan be reduced by the amount of any prescribed assistance received in respect of the shares. For this purpose, certain government assistance that does not cause a reduction in the adjusted cost base of such shares is prescribed in section 6702 of the *Income Tax Regulations*.

Subparagraph 40(2)(i)(ii) of the Act is amended to provide that prescribed assistance receivable in respect of a share also will result in a reduction of any capital loss on the disposition of the share. A parallel amendment to clause 53(2)(k)(i)(C) of the Act provides that such assistance does not result in a reduction of the adjusted cost base of a share.

This amendment applies to the 1991 and subsequent taxation years.

Clause 16

Dispositions of Remainder Interests

ITA
43.1

Section 43.1 of the Act deals with the disposition of a remainder interest in real property by a taxpayer who retains the life estate or estate *pur autre vie* in the property. Subsection 43.1(1) provides that, in such a case, the taxpayer will be deemed to have disposed of the life estate that has been retained, for proceeds equal to its fair market value at the time the remainder interest is disposed of, and to have reacquired the life estate immediately after that time at the same fair market value. The provisions of subsection 43.1(1) do not apply in cases where the remainder interest is disposed of to a registered charity that is not a charitable foundation.

This amendment to subsection 43.1(1) broadens this exemption from the deemed disposition rules by providing that the subsection does not apply where a gift of a remainder interest in real property is made to a donee described in the definition of "total charitable gifts or "total Crown gifts" in subsection 118.1(1) of the Act. These donees include registered charities and federal and provincial governments, as well as certain other organizations.

This amendment applies to dispositions occurring after December 20, 1991.

Clause 17

Exchanges of Property

ITA
44

Section 44 of the Act allows a taxpayer to defer the recognition of a capital gain in respect of property under certain circumstances.

Subclause 17(1)

ITA
44(2)(d)

Subsection 44(2) of the Act provides rules for determining the time at which a taxpayer will be considered to have disposed of a property which was the subject of an involuntary disposition (e.g., theft, destruction or expropriation). This subsection is amended to replace a reference to section 48 of the Act, which deems certain property to have been disposed of where a taxpayer has ceased to be a resident of Canada, with a reference to new paragraph 128.1(4)(b) of the Act. New paragraph 128.1(4)(b) forms part of a set of amendments concerning taxpayers' residence and certain related matters. Thus where property has been involuntarily disposed of and paragraph 128.1(4)(b) subsequently applies to the taxpayer, the involuntary disposition will be considered to have occurred no later than that subsequent time.

This amendment generally applies after 1992, although it may also apply before that time to corporations electing to be subject to new subsection 250(5.1) of the Act. For further information, reference may be made to the commentary on that provision.

Subclause 17(2)

ITA
44(6)

Subsection 44(1) of the Act allows a taxpayer who incurs a capital gain on the disposition of certain property to defer tax on the gain to the extent that the taxpayer reinvests the proceeds of disposition in a replacement property within a certain period of time.

Subsection 44(6) of the Act provides a special rule for a taxpayer who has disposed of a former business property, where the property consists in part of a building and in part of related land. In such circumstances, the taxpayer may elect, for purposes of the rule provided under subsection 44(1), to treat any excess of the proceeds of disposition of such part of the property over the replacement cost of that part as proceeds of disposition of the other part. This would allow for a complete rollover where a taxpayer has moved from one location to another location and replaced the old building and land with a new building and land having a combined cost equal to the proceeds of sale of the old property, even though the new land is less expensive than the old land and the new building is more expensive than the old building.

Subsection 44(6) of the Act is amended to provide that any reallocated proceeds of disposition under that subsection apply for the purposes of subdivision c, rather than only for the purposes of subsection 44(1). For example, the reallocated proceeds of disposition in respect of the land and building apply for the purposes of both subsection 44(1) and subsection 40(1) of the Act. Subsection 40(1) provides general rules for determining a taxpayer's capital gain or capital loss for a taxation year.

This amendment applies to dispositions occurring after December 21, 1992.

Clause 18

Property With More Than One Use

ITA
45(2)

Subsection 45(1) of the Act provides for a deemed disposition and reacquisition of property where its use, or a proportion of its use, is altered from personal use to income-earning or producing use, or vice-versa.

Subparagraph 45(1)(a)(i) of the Act provides that, where there is a change of use of property acquired for some other purpose to a use that is for the purpose of gaining or producing income, a taxpayer will be deemed to have disposed of the property for proceeds of disposition equal to the fair market value of the property and to have reacquired it immediately thereafter at a cost equal to that fair market value. Paragraph 13(7)(b) of the Act provides a similar rule for determining the capital cost of property where a taxpayer, having acquired the property for some other purpose, commences to use the property for the purpose of gaining or producing income.

Subsection 45(2) of the Act provides that, for the purposes of subdivision c and section 13 of the Act, a taxpayer may file an election in respect of property to treat it as if a change of use does not occur. The election is required to be filed with the taxpayer's return of income under Part I for the year that the change of use occurs. A taxpayer may rescind the election in a return of income under Part I for a subsequent year with the changed use commencing on the first day of that subsequent year.

Subsection 45(2) of the Act is amended to clarify that an election may be made in respect of non-depreciable capital property. For example, a taxpayer may file an election in respect of non-depreciable capital property that is land, the use of which would otherwise be considered to have changed to gaining or producing income.

Subsection 45(2) is also amended to delete the words "therefrom or for the purpose of gaining or producing income from a business". This change is consistent with the amendments made to the Act by the enactment of Bill C-139 which, among other things, changed the application of the change-of-use rules so that the rules do not apply where the change is among earning income from business, employment or property.

This amendment applies to the 1992 and subsequent taxation years.

Clause 19

Changes in Residence

ITA
48

Section 48 of the Act provides rules that apply when a taxpayer becomes or ceases to be resident in Canada. In general, section 48 deems certain property to have been disposed of when a taxpayer ceases to reside in Canada, and to have been acquired when a taxpayer becomes a Canadian resident, for purposes of computing the taxpayer's capital gains and losses. New section 128.1 of the Act adopts an amended version of these rules for all purposes of the Act, and thus makes section 48 redundant.

Section 48 is repealed effective after 1992, but the repeal comes into force earlier in respect of corporations electing to be subject to new subsection 250(5.1) of the Act. For further information, reference may be made to the commentary on that provision.

Clause 20

Convertible Property

ITA
51

Section 51 of the Act generally permits a tax-deferred transfer of property where a taxpayer, pursuant to a right of conversion, exchanges capital property that is a share, bond, debenture or note of a corporation for capital property that is another share of the capital stock of the corporation.

Subsection 51(1) of the Act is amended, effective for exchanges occurring after December 21, 1992, to provide that where shares of a corporation are exchanged for other shares of the same corporation, a rollover will be available even though the terms and conditions of the exchanged shares do not provide a right of exchange or conversion.

Although subsection 51(1) of the Act is intended to provide rollover treatment for certain share-for-share exchanges, a shareholder could be deemed by section 84 to have received a dividend where the stated capital of the old shares exceeds the paid-up capital of the old shares for tax purposes. Such a paid-up capital deficiency could arise, for example, where subsection 85(2.1) of the Act applies to reduce the paid-up capital of a class of shares as a consequence of a previous transfer of property to which subsection 85(1) applied. New subsection 51(3) of the Act reduces the paid-up capital of the classes of shares received on the exchange. The effect of the reduction is to permit the paid-up capital deficiency of the old shares to flow through to the new shares received on the exchange, thereby ensuring that the exchange will not result in any increase in paid-up capital to which subsection 84(1) of the Act could apply and that the amount received for the old shares for purposes of subsection 84(3), having regard to subsection 84(5), will be equal to the paid-up capital of the old shares. A similar provision is being added to section 86 of the Act in respect of share exchanges to which subsection 86(1) applies. New subsection 51(3) applies to share exchanges occurring after December 20, 1992 and, unless the corporation elects within a certain time limit not to have it apply, to share exchanges occurring before December 21, 1992 and after August 1992.

New subsection 51(4) of the Act, applicable in respect of exchanges occurring and reorganizations beginning after December 21, 1992, provides that section 51 will only apply where neither section 86 nor subsection 85(1) or (2) applies. Consequential to this amendment, subsection 86(3) of the Act is amended to delete the reference to section 51.

Clause 21

Cost of Shares on Immigration

ITA
52(8)

Section 52 of the Act sets out rules for determining the cost to a taxpayer of various types of property. New subsection 52(8) provides that the cost to a non-resident taxpayer of shares of a corporation that has become resident in Canada shall be deemed to be the lesser of that cost otherwise determined and the paid-up capital in respect of the share immediately after the corporation became resident. This new provision, which forms part of a set of amendments concerning taxpayers' residence and certain related matters, ensures the appropriate measurement of any gain or loss on the sale of a share of an immigrant corporation by a non-resident shareholder.

New subsection 52(8) applies after 1992.

Clause 22

Adjustments to Cost of Property

ITA
53(2)(k)

Section 53 of the Act sets out rules for determining the adjusted cost base of capital property for the purposes of calculating any gain or loss on its disposition.

Paragraph 53(2)(k) of the Act provides that the adjusted cost base of a property is reduced by the amount of government assistance received or receivable. However, clause 53(2)(k)(i)(C) provides that this reduction does not apply to prescribed assistance received for shares of a prescribed venture capital corporation, or a prescribed labour-sponsored venture capital corporation or to shares of a taxable Canadian corporation that are held in a prescribed stock savings plan. For this purpose, certain government assistance is prescribed in section 6702 of the *Income Tax Regulations*.

Clause 53(2)(k)(i)(C) of the Act is amended to provide that prescribed assistance receivable in respect of a share does not result in a reduction of the adjusted cost base of the share. A parallel amendment to paragraph 40(2)(i) of the Act provides that such assistance will result in a reduction of any capital loss on the disposition of such a share.

This amendment applies to the 1991 and subsequent taxation years.

Clause 23

Changes in Residence

ITA
54

"superficial loss"

Section 54 of the Act defines various terms for the purposes of subdivision c of Division B of Part I of the Act (Taxable Capital Gains and Allowable Capital Losses). The definition of the term "superficial loss" contained in section 54 is amended to add to its reference to section 48 of the Act, which deems a disposition where the taxpayer has ceased to be a resident of Canada, a reference to new section 128.1 of the Act. New section 128.1 forms part of a set of amendments concerning taxpayers' residence and certain related matters.

This amendment generally applies after 1992, although it may also apply before that time to corporations electing to be subject to new subsection 250(5.1) of the Act. For further information, reference may be made to the commentary on that provision.

Clause 24

Divisive Reorganizations – Non-Resident Shareholders

ITA
55(3.1)

Section 55 of the Act deals with certain tax avoidance transactions.

Subsection 55(2) of the Act is an anti-avoidance provision directed against certain arrangements designed to convert a capital gain on a disposition of shares into a tax-free intercorporate dividend. It treats a dividend received in these circumstances as either a capital gain or proceeds of disposition that are taken into account in computing a capital gain.

Subsection 55(3) of the Act provides two exemptions from this rule. The first applies to a dividend received as part of a series of transactions that does not include a disposition of property to, or a significant increase in the interest in any corporation of, any person who deals at arm's length with the dividend recipient. The second exemption applies to a dividend received in the course of a reorganization – commonly referred to as a "butterfly" reorganization – in which property of a corporation is transferred to one or more of its corporate shareholders with each transferee receiving its pro-rata share, based on the fair market value of its shares of the transferor, of each type of property transferred.

New subsection 55(3.1) of the Act provides that the second exemption does not apply in certain circumstances. Specifically, new subsection 55(3.1) excludes from the protection of subsection 55(3) a dividend described in paragraph 55(3)(b) where the dividend is received as part of a series of transactions in which

- a foreign vendor (including a partnership any member of which is resident in a country other than Canada) disposes of

  - a share of the capital stock of the particular corporation referred to in paragraph 55(3)(b) or of a transferee corporation that is taxable Canadian property of the foreign vendor, or

  - property the fair market value of which is derived principally from such shares, and

- such share or other property disposed of by the foreign vendor, or property acquired in substitution therefor, is acquired by any person (other than the particular corporation) or partnership that deals at arm's length with the foreign vendor.

New subsection 55(3.1) is effective for dividends received after May 4, 1993, other than a dividend arising from a transaction occurring as part of a series of transactions or events in which the foreign vendor was obliged on that date to dispose of the share or other property described in paragraph 55(3.1)(a) pursuant to an agreement in writing entered into before May 5, 1993.

Clause 25

Amounts to be Included in Income

ITA
56

Section 56 of the Act lists certain types of income that are required to be included in computing income for a taxation year from a source other than property, business or employment and other than from the disposition of capital properties.

Subclause 25(1)

ITA
56(1)(a)(vi) and (vii)

Under subparagraphs 56(1)(a)(vi) and (vii) of the Act, benefits received under the *Labour Adjustment Benefits Act* (which provides for the payment of benefits to laid-off workers) and income assistance payments made pursuant to an agreement under section 5 of the *Department of Labour Act* (which provides for income assistance benefits under the Program for Older Worker Adjustment) are included in income.

This amendment to paragraph 56(1)(a) of the Act replaces subparagraphs 56(1)(a)(vi) and (vii) with new subparagraph 56(1)(a)(vi). This new subparagraph provides that, except to the extent otherwise required to be included in a taxpayer's income under the Act, prescribed benefits received under government assistance programs are included in income under paragraph 56(1)(a). The *Income Tax Regulations* will be amended to prescribe benefits received under the *Labour Adjustment Benefits Act* and under section 5 of the *Department of Labour Act* for purposes of new subparagraph 56(1)(a)(vi), so that the tax treatment of such payments remains unchanged.

Payments under two additional government assistance programs will also be prescribed for purposes of new subparagraph 56(1)(a)(vi) of the Act. These are income assistance payments received under the Plant Workers Adjustment Program (as a result of an agreement under section 5 of the *Department of Fisheries and Oceans Act*) and income assistance payments under the Northern Cod Compensation and Adjustment Program. This recognizes the existing treatment of payments under these two programs, under which such payments are subject to tax.

This amendment applies to benefits received after October 1991.

Subclause 25(2)

ITA
56(1)(d.2)

Paragraph 56(1)(d.2) of the Act provides for the inclusion in income of any amount received from an annuity, where the payment for the annuity was deductible in computing income by reason of paragraph 60(l) or former subsection 146(5.5) (which dealt with the acquisition of annuities described in paragraph 60(l) by individuals who realized capital gains with respect to the disposition of farm property in 1984):

Paragraph 56(1)(d.2) is amended also to provide an inclusion in income of any amount received from an annuity, where the payment for the annuity was made in circumstances to which new subsection 146(21) applies. As further described below, this new provision allows lump sum amounts to be transferred from prescribed provincial pension plans to acquire an annuity described in paragraph 60(l).

This amendment applies to the 1992 and subsequent taxation years.

Subclause 25(3)

ITA
56(4)

Subsection 56(4) of the Act provides that where a right to receive income is transferred to a person with whom the transferor does not deal at arms length, income received under that right is income of the transferor except in specified circumstances. Subsection 56(4) is amended to provide that only such income relating to a period in a taxation year throughout which the transferor is resident in Canada will be included in computing the transferor's income by reason of this subsection. In addition, subsection 56(4) is amended to delete the phrases "(whether before or after the end of 1971)" and "because the amount would have been received or receivable by the taxpayer in or in respect of the year".

These amendments apply to the 1992 and subsequent taxation years.

Subclause 25(4)

ITA
56(4.1)

Subsection 56(4.1) of the Act applies in certain cases to attribute income from one individual ("the transferee") to another individual ("the transferor") with whom the transferee does not deal at arm's length. The rules do not apply unless the transferee, or a trust in which the transferee is beneficially interested, receives a loan from, or becomes indebted to, the transferor. In addition, the rules do not apply unless it is reasonable to consider that one of the main reasons for making the loan or incurring the indebtedness was to reduce or avoid tax by causing income from the loaned property, property that the loaned property enabled or assisted the transferee to acquire or property substituted for such property to be included in the income of the transferee.

Subsection 56(4.1) is amended so that it may also apply where one of the main purposes of making a loan or incurring indebtedness was to reduce or avoid tax by causing income from property that the loan or indebtedness enabled or assisted a trust in which a transferee is beneficially interested to acquire to be included in the income of the transferee.

This amendment applies with respect to income relating to periods commencing after December 21, 1992.

Clause 26

Deductions in Computing Income

ITA
60

Section 60 of the Act provides for a variety of deductions in computing income, many of which relate to certain income inclusions required under section 56 of the Act.

Subclause 26(1)

ITA
60(j.2)

Paragraph 60(j.2) of the Act allows a taxpayer a deduction for a taxation year in respect of periodic payments received out of a registered pension plan or a deferred profit sharing plan that are paid in the year or not more than 60 days after the end of the year to a registered retirement savings plan under which the taxpayer's spouse is the annuitant. The deduction is limited to a maximum of $6,000 per year and is no longer available after the 1994 taxation year.

Paragraph 60(j.2) is amended so that, where an individual dies in a taxation year or within 60 days after the end of the year, a deduction under the paragraph may be claimed on behalf of the individual for the year with respect to RRSP premiums paid on behalf of the individual to an RRSP under which the individual's widow or widower is the annuitant. This is consistent with a similar amendment to subsection 146(5.1) of the Act.

This amendment applies to the 1992 and subsequent taxation years.

Subclauses 26(2) and (3)

ITA
60(l)(v)(B.1)

Paragraph 60(l) of the Act provides a minor with a deduction for the cost of acquiring an annuity where the term of the annuity does not exceed 18 years minus the age of the minor at the time of the acquisition of the annuity. The cost of acquisition cannot exceed such portion of the sum (such portion referred to below as the "limit") of the total refunds of premiums under registered retirement savings plans (RRSPs) and registered retirement income funds (RRIFs) and the total lump sum payments from registered pension plans paid as a consequence of the death of a parent or grandparent of the minor as is included in computing the minor's income. (An income inclusion for a minor in this respect would generally arise only from the application of the "flow-through" rules in subsection 104(27), 146(8.1) and subsection 146.3(6.1).) Where the minor was dependent by reason of physical or mental infirmity on the deceased, paragraph 60(l) also allows the minor to transfer refunds of premiums referred to above to an RRSP, RRIF, life annuity or a term annuity up to age 90.

Subclause 60(l)(v)(B.1)(II) of the Act, which restricts the deduction for a minor to the limit described above, is amended so that "designated benefits" of a minor in respect of RRIFs are also included in computing the limit. This change is consequential to amendments to subsections 146.3(6.1) and (6.2) of the Act under which amounts which were formerly treated as "refunds of premiums" under RRIFs are now "designated benefits". For further detail, see the commentary on the amendments to those subsections.

Subclause 60(l)(v)(B.1)(II) is also amended to add a reference to new clause 60(l)(v)(B.2) of the Act. This amendment ensures that a physical or mentally infirm minor is not entitled to a deduction under paragraph 60(l) of an amount in excess of the minor's transfers to RRSPs, RRIFs and annuities under paragraph 60(l). This amendment is strictly consequential on the addition of new clause 60(l)(v)(B.2).

Clause 60(l)(v)(B.1) is amended so that the above limit of a minor is reduced to the extent that "designated benefits" of the minor in respect of RRIFs exceed "eligible amounts" of the minor in respect of those funds, computed on the assumption that the formula for the computation of an "eligible amount" in new subsection 146.3(6.11) of the Act applied. As discussed in the commentary to subsection 146.3(6.11), such an excess would arise for a taxation year only to the extent that minimum amounts in respect of RRIFs for the year were not withdrawn prior to the death of the last annuitant under the RRIFs.

These amendments apply to the 1993 and subsequent taxation years.

Subclause 26(4)

ITA
60(l)(v)(B.2)

Paragraph 60(l) of the Act allows a deduction to an individual who receives specified amounts of retirement income and transfers a designated portion of such income to a registered retirement savings plan, a registered retirement income fund or to acquire a specified annuity. Such income includes, under clause 60(l)(v)(B.2), amounts received by an individual out of or under a prescribed provincial pension plan (i.e. the Saskatchewan Pension Plan) as a consequence of the death of the individual's spouse. Transfers of such death benefits may be indirect (i.e. actually received by a taxpayer and subsequently transferred by the taxpayer not more than 60 days after the taxation year of receipt) or direct.

Clause 60(l)(v)(B.2) of the Act is repealed to disallow the transfer of such death benefits under paragraph 60(l). Instead, a measure allowing for the direct tax-free transfer of lump sum amounts from prescribed provincial pension plans is introduced in new subsection 146(21) of the Act. A new clause 60(l)(v)(B.2) is introduced, as discussed below.

New clause 60(l)(v)(B.2) of the Act is added to allow an individual a deduction with respect to funds transferred by the individual to RRSPs or RRIFs or to acquire life annuities described in subparagraph 60(l)(ii). The additional deduction permitted as a consequence of this clause cannot exceed the "eligible amounts" of the individual in respect of RRIFs. This amendment is necessary, in part, because amounts from RRIFs will no longer be treated as "refunds of premiums" by virtue of amended subsections 146.3(6.1) and (6.2), and thus are no longer eligible for transfer under clause 60(l)(v)(B). For further information reference may be made to the definition of "eligible amount" described in the commentary to new subsection 146.3(6.11) of the Act.

These amendments apply to the 1993 and subsequent taxation years. However, the restriction on the transfer of death benefits from the Saskatchewan Pension Plan also applies to the 1992 taxation year unless the taxpayer elects otherwise by notifying the Minister of National Revenue in writing. It is intended that a designation made under paragraph 60(l) in respect of a death benefit from a prescribed provincial pension plan may be regarded as an election for this purpose. The purpose of this transitional rule is to facilitate the indirect transfer of such death benefits with respect to the 1992 taxation year. Where such an election is made by a taxpayer, new subsection 146(21) will not apply to transfers of such death benefits in 1992.

Subclause 26(5)

ITA
60(l)(v)(D)

Paragraph 60(l) of the Act also allows an individual a deduction with respect to funds transferred by the individual to RRSPs or RRIFs or the issuer of a qualifying annuity on the basis of payments from a RRIF to the individual in excess of the minimum amount under the RRIF. To qualify for the deduction, clause 60(l)(v)(D) requires that the transfer must be made directly.

Clause 60(l)(v)(D) is amended so that, where a taxpayer has become an annuitant under a registered retirement income fund as a consequence of the death of the taxpayer's spouse, amounts received by the deceased spouse out of or under the fund are taken into account in determining the amount which may be transferred pursuant to clause 60(l)(v)(D). For example, if an individual receives the minimum amount under a registered retirement income fund in a taxation year and dies later in that year, the surviving spouse of the individual who becomes the annuitant under the fund will be able to transfer the full balance under the fund later in that year under paragraph 60(l).

Clause 60(l)(v)(D) is also amended to ensure that an amount from a RRIF is included thereunder in respect of an individual only where the individual is the annuitant under the RRIF. However, where the individual is the spouse or a mentally or physically infirm child of the last annuitant under the RRIF, transfers under paragraph 60(l) are still allowed to the extent permitted under clause 60(l)(v)(B.2). (In addition, if the individual is under 18 years of age, a term annuity to age 18 may in some cases be acquired pursuant to clause 60(l)(v)(B.1).)

These amendments apply to the 1993 and subsequent taxation years. However, where an individual's spouse died before 1993 and was an annuitant under a RRIF, these amendments still allow the individual a deduction for the 1993, 1994, 1995 or 1996 taxation year with respect to a payment from the RRIF that is included in computing the individual's income for the year.

Subclause 26(6)

ITA
60(n)(i.1)

Paragraph 60(n) of the Act allows a deduction to an individual where the individual repays an overpayment of certain amounts received and included in the income of the individual for the year or a preceding year. New subparagraph 60(n)(i.1) adds repayments of retiring allowances included in income under subparagraph 56(1)(a)(ii) of the Act to the list of such deductible repayments. This amendment applies to repayments of retiring allowances made after 1990.

Subclause 26(7)

ITA
60(n)(ii.2)

Subparagraph 60(n)(ii.2) of the Act provides that repayments of amounts described in subparagraph 56(1(a)(vii) of the Act (income assistance payments made pursuant to an agreement under section 5 of the *Department of Labour Act*) may be deductible from income. Subparagraph 60(n)(ii.2) is repealed as a consequence of the amendments to paragraph 56(1)(a) of the Act. Those amendments replace subparagraphs 56(1)(a)(vi) and (vii) with new subparagraph 56(1)(a)(vi), under which a prescribed benefit under a government assistance program is included in an individual's income. As a result, repayments of such prescribed benefits (which will include income assistance payments made pursuant to an agreement under section 5 of the *Department of Labour Act*) may be deducted from income under existing subparagraph 60(n)(ii.1) of the Act.

The repeal of subparagraph 60(n)(ii.2) applies to repayments made after October 1991, the same time at which the amendments to subparagraphs 56(1)(a)(vi) and (vii) take effect. For further information, reference may be made to the commentary on those subparagraphs.

Clause 27

Child Care Expenses

ITA
63(4)

Section 63 of the Act provides rules concerning the deductibility of child care expenses.

The definition of child care expense in subsection 63(3) of the Act requires that the related child care services be provided in Canada by a person resident in Canada. New subsection 63(4) provides an exception to recognize as eligible child care expenses, in certain circumstances, amounts paid for child care services provided in the U.S. to persons who reside near the Canada-U.S. boundary and commute to work in the U.S. or who must travel through the U.S. from their residences in Canada to work in other locations in Canada that can only be reached by access routes through the U.S. This amendment applies to the 1992 and subsequent taxation years.

Clause 28

Principal-Business Corporations

ITA
66(15)

"principal-business corporation"

A "principal-business corporation" is defined in subsection 66(15) of the Act as a corporation whose principal business is one of a number of activities specified in the definition. It also generally includes a corporation all or substantially all of the assets of which are shares in the capital stock of one or more other related corporations the principal businesses of which consist of such activities.

The definition of "principal-business corporation" is amended to add the following specified activities:

- the processing of mineral ores for the purpose of recovering minerals from such ores,

- the processing or marketing of minerals or metals that were recovered from mineral ores and that include minerals or metals recovered from mineral ores processed by the corporation,

- the production or marketing of calcium chloride, gypsum or kaolin, and

- the manufacturing of products, where such manufacturing involves the processing of calcium chloride, gypsum or kaolin.

The definition is also clarified to ensure that any combination of the activities described can result in a corporation qualifying as a "principal-business corporation".

In addition, the portion of the definition allowing a holding corporation to qualify as a "principal-business corporation" is amended to provide that a corporation qualifies as a principal-business corporation if all or substantially all of its assets consist of shares of the capital stock or indebtedness of principal-business corporations related to it (otherwise than because of a right referred to in paragraph 251(5)(b)).

These amendments apply to the 1993 and subsequent taxation years. However, a corporation may elect that the amendments not apply for the 1993 to 1996 taxation years by notifying the Minister of National Revenue before the end of the sixth month following the month of Royal Assent. In addition, the amendments do not apply to transactions or events occurring before the 1993 taxation year. For example, if the successor rules applied to a transaction before 1985 pursuant to paragraph 66.7(7)(a), these amendments will not result in the successor rules ceasing to apply to that transaction for the 1993 and subsequent taxation years.

Clause 29

Canadian Development Expense

ITA
66.2

Section 66.2 of the Act provides rules relating to the deduction of "Canadian development expense" as defined in subsection 66.2(5).

Subclause 29(1)

ITA
66.2(5)

"cumulative Canadian development expense" (Description of F)

Subsection 66.2(5) of the Act contains the definition of "cumulative Canadian development expense" (CCDE). A taxpayer's CCDE includes the taxpayer's undeducted pool of Canadian development expenses. It is reduced by a number of amounts, including the total set out in the description of F in that definition. A taxpayer is permitted a deduction under subsection 66.2(2) with respect to a positive CCDE. A "negative" CCDE is included in a taxpayer's income under subsection 66.2(1).

If a taxpayer disposes of a Canadian resource property described in paragraph (b), (e) or (f) of the definition of "Canadian resource property" in subsection 66(15) ("Canadian mining property"), the deduction in computing the taxpayer's CCDE in the description of F is generally equal to the taxpayer's proceeds of disposition (net of otherwise non-deductible outlays made for the purposes of making the disposition). In the event that Canadian mining property was acquired by the taxpayer in circumstances in which the successor rules under section 66.7 of the Act apply, there may be CCDE or cumulative Canadian oil and gas property expense (CCOGPE) relating to expenditures originally incurred by an original owner that are available for deduction under subsection 66.7(4) or (5) by the taxpayer. (These amounts are referred to as a taxpayer's successored CCDE balance or successored CCOGPE balance in respect of an original owner.) A taxpayer's successored CCDE balances under paragraph 66.7(4)(a) in respect of original owners of Canadian mining property are used to offset the reduction in the taxpayer's CCDE otherwise arising, by virtue of the description of F, from the disposition of such property.

The description of F in the definition of CCDE is amended so that the offset referred to above in respect of a disposition of Canadian mining property by a taxpayer is not determined with reference to the current amounts of the taxpayer's successored CCDE balances. Rather, the offset is to be determined with reference to the amounts of a taxpayer's successored CCDE balances immediately before the proceeds became receivable. In effect, the proceeds of disposition of Canadian mining property acquired on a succession are intended to be applied first to reduce any successored CCDE balances before any unapplied portion of the proceeds is applied to reduce the taxpayer's own CCDE. This amendment is consistent with the scheme of the successor rules prior to the enactment of Bill C-64 in 1987.

More specifically, the amended description of F provides that the total offsets referred to above that may be provided with respect to the disposition of Canadian mining property at a particular time cannot exceed a specified amount. The specified amount is equal to the total reductions in the taxpayer's successored CCDE balances by virtue of the disposition in respect of all persons who are original owners with respect to all or part of such property.

The description of F is also amended to ensure that, in determining a taxpayer's successored CCDE balance as of any particular time, amounts receivable by the taxpayer after that time are not taken into account. This amendment is necessary because ordinarily amounts receivable up to the end of a taxation year are relevant in determining a taxpayer's successored CCDE balance at any time in the year.

The description of F is also amended to make reference to new subparagraph 66.7(4)(a)(iii) of the Act, which is taken into account in computing a taxpayer's successored CCDE balances after 1992. This subparagraph applies only to the extent that the taxpayer designates amounts in prescribed form on a timely basis. For the purposes of computing the reduction of a taxpayer's successored CCDE balances in the description of F, it is assumed that the reductions in successor CCDE balances ultimately arising as a consequence of the designation of proceeds under subparagraph 66.7(4)(a)(iii) occur at the time the proceeds become receivable.

Examples of the intended effect of these amendments are contained in the commentary on the amendment to subparagraph 66.7(4)(a)(ii) of the Act.

These amendments apply to taxation years ending after February 17, 1987.

Subclause 29(2)

ITA
66.2(5)

"cumulative Canadian development expense" (Description of L)

Subsection 66.4(5) of the Act contains the definition of CCOGPE. A taxpayer's CCOGPE includes the taxpayer's undeducted pool of Canadian oil and gas property expenses. A taxpayer is permitted a deduction under subsection 66.4(2) of the Act with respect to a positive CCOGPE. A taxpayer's CCOGPE is reduced by virtue of the disposition of Canadian resource property described in paragraph (a), (c) or (d) of the definition of "Canadian resource property" in subsection 66(15) ("Canadian oil and gas property").

A "negative" CCOGPE (determined at the end of a taxation year) reduces a taxpayer's CCDE pursuant to the description of L in the definition of CCDE in subsection 66.2(5). However, this reduction is offset by the lesser of two amounts. The first amount (as determined under paragraph (a) of the description of L) is the taxpayer's successored CCDE balance in respect of an original owner. The second amount (as determined under paragraph (b) of the description of L) is the proceeds of disposition that have previously become receivable by the taxpayer with respect to "successored" Canadian oil and gas property acquired by the taxpayer from that original owner (or a successor to that original owner) minus the amount that would be the taxpayer's successored CCOGPE balance in respect of the original owner if amounts that became receivable with respect to Canadian oil and gas properties were not taken into account.

The description of L is amended so that amounts that become receivable after 1992 with respect to "successored" Canadian oil and gas property in respect of an original owner will no longer increase the second amount referred to above. As provided in new subparagraph 66.7(4)(a)(iii) of the Act, such proceeds can be designated by a successor to reduce a successor CCDE balance in respect of an original owner to the extent that there is no successor CCOGPE balance in respect of the original owner against which such proceeds may be applied. A designation under new subparagraph 66.7(4)(a)(iii) has the advantage of reducing (by virtue of new paragraph (c) of the description of F in the definition of CCOGPE) the amount required to be deducted in computing the successor's own CCOGPE.

The description of L is also amended so that the offset is the least of three amounts (rather than the lesser of the two amounts described above). As provided in new paragraph (c) of the description of L, the third amount is nil. The new paragraph applies only in respect of a taxpayer who has acquired property as a successor where the taxpayer subsequently disposes of property in circumstances in which the successor rules apply. However, it does not apply where the successor rules apply because of an amalgamation or merger or by reason of the change of control rules in subsection 66.7(10) of the Act. It also does not apply as a result of successor transactions by a taxpayer before December 22, 1992, or successor transactions pursuant to agreements in writing entered into before that time, unless the winding-up of the taxpayer has commenced.

The addition of paragraph (c) to the description of L is appropriate because, where there has been a disposition to another corporation by a taxpayer in circumstances in which the successor rules apply, a taxpayer's successored CCDE balances (on which the first amount used in determining the offset is based) become available to the other corporation. While the first amount is required to be reduced on an on-going basis to reflect deductions claimed by successors and dispositions of successored Canadian resource property, serious practical difficulties arise if the taxpayer has wound-up before successored CCDE balances are fully deducted or where the taxpayer does not have sufficient information for the purposes of the on-going calculation of the successored CCDE balances.

The above amendments will reduce the significance of the description of L with respect to future transactions. The amendments described below correct minor technical deficiencies with respect to the existing wording of the provision.

The description of L is amended so that the first and second amounts relevant for the computation of the offset described above are determined on a year-end basis, in order to be consistent with the inclusion of a "negative" CCOGPE balance at the end of a taxation year.

Paragraph (a) of the description of L is amended to clarify that the first amount relevant in computing the offset is based on the taxpayer's successored CCDE balance in respect of a particular disposition of Canadian resource property by an original owner. It is possible that the same person may have disposed of different Canadian resource properties to a taxpayer in two separate transactions in which the successor rules applied, in which case the taxpayer would have two relevant successored CCDE balances in respect of that person for the purposes of this clause.

Paragraph (a) of the description of L is also amended, in conjunction with an amendment to subsection 66.7(14) described below, to ensure that a taxpayer's successored CCDE balance is maintained for the purposes of computing the first amount after the taxpayer transfers property in circumstances in which the successor rules apply.

Paragraph (b) of the description of L is amended to modify the second amount relevant in computing the offset. As discussed above, the first amount is based on the taxpayer's successored CCDE balance in respect of the original disposition of Canadian resource property by an original owner. By virtue of this amendment the second amount is not reduced by virtue of proceeds of disposition that became receivable before 1993 by a predecessor owner that reduced the successored CCOGPE balance in respect of the original owner that is available to the successor. This relieving amendment is consistent with the application of this clause prior to the enactment of Bill C-64 in 1987.

These amendments apply to taxation years ending after December 21, 1992, except that a taxpayer may elect to have the amendments apply to taxation years ending after February 17, 1987 by filing a notice in writing with the Minister of National Revenue. The notice must be filed by the end of the sixth month after the end of the taxation year of the taxpayer in which Royal Assent to these amendments occurs. If the notice is given by a taxpayer, the Minister of National Revenue can reassess the taxpayer's statute-barred taxation years to take into account the election.

Clause 30

Canadian Oil and Gas Property Expense

ITA
66.4

Section 66.4 of the Act provides rules relating to the deduction of "Canadian oil and gas property expense" as defined in subsection 66.4(5).

Subclause 30(1)

ITA
66.4(1)

When subsection 66.4(1) of the Act was amended by chapter 49 of the *Statutes of Canada,* 1991 (Bill C-18), the reference to subparagraph 66.4(5)(b)(ii) in the English version of the subsection was inadvertently changed to a reference to subparagraph 66.4(5)(b)(i). This amendment to the English version of subsection 66.4(1), which applies to taxation years that end after February 17, 1987, (the date at which the amendment in Bill C-18 to the subsection came into force) restores the correct reference.

Subclause 30(2)

ITA
66.4(5)

"cumulative Canadian oil and gas property expense" (Description of F)

The amendments to the description of F in the definition of CCOGPE are parallel to the amendments to the description of F in the definition of CCDE. Except for the introduction of new paragraph (c) in the description of F in the CCOGPE definition, the only difference between the two descriptions is that the description of F in the CCOGPE definition deals with Canadian oil and gas properties, while the description of F in the CCDE definition deals with Canadian mining properties.

Paragraph (c) of the description of F in the CCOGPE definition is introduced so that decreases in a taxpayer's successor CCDE balances arising from the disposition of Canadian oil and gas properties correspondingly decrease the reduction in the taxpayer's CCOGPE which otherwise arises as a result of the disposition. This offset is consequential on the introduction of subparagraph 66.7(4)(a)(iii) of the Act.

These amendments apply to taxation years ending after February 17, 1987. However, the introduction of paragraph (c) in the description of F is relevant only with respect to amounts that become receivable after 1992. For further detail in this respect, see the commentary on new subparagraph 66.7(4)(a)(iii).

Clause 31

Successor Rules

ITA
66.7

Section 66.7 of the Act provides rules relating to the deduction, by a "successor corporation", of unused resource expenses of another person in respect of resource properties acquired by the successor corporation.

Subclause 31(1)

ITA
66.7(2)(b)(ii)(B)

Subsection 66.7(2) of the Act provides a successor deduction for corporations in respect of foreign exploration and development expenses (FEDE) incurred by other taxpayers. This subsection is amended to correct a reference which was included when subsection 66.7(2) was extended to allow an election (similar to the election formerly provided in paragraph 66.7(10)(f)) to use specified Canadian resource income as streamed income against which FEDE could be claimed by a successor.

This amendment applies to taxation years ending after February 17, 1987.

Subclause 31(2)

ITA
66.7(4)(a)(ii) and (iii)

Subsection 66.7(4) of the Act provides a deduction for a taxpayer in respect of the taxpayer's successored CCDE balances in respect of original owners. Deductions under this subsection are determined on a property-by-property basis. A deduction with respect to a particular property may be claimed by a taxpayer equal to the total specified amounts determined with respect to original owners of that particular property. The specified amount in respect of an original owner and a particular property is, in general terms, the lesser of:

- 30% of the taxpayer's successored CCDE balance in respect of the original owner (or, more specifically, 30% of the amount by which the undeducted CCDE in respect of the original owner exceeds, where the particular property is Canadian mining property, proceeds of disposition for the particular property that had become receivable by the taxpayer or a predecessor owner), and

- income from the production of the particular property (commonly referred to as "streamed income"), computed without reference to resource deduction provisions in the Act.

In determining the above amounts, no part of a successor CCDE balance may be deducted more than once (subclauses 66.7(4)(a)(i)(A)(I) to (II)), nor can particular amounts of streamed income be used more than once as the basis for deduction under section 66.7 (subparagraph 66.7(4)(b)(ii) and parallel provisions in subsections 66.7(1), (3) and (5)).

Subparagraph 66.7(4)(a)(ii) is amended to ensure that, in computing a successor CCDE balance of an original owner in respect of a particular property, there is deducted other proceeds of disposition with respect to other Canadian mining property owned by the original owner before being acquired with the particular property by a successor to the original owner.

Subparagraph 66.7(4)(a)(ii) is also amended so that, where there is more than one original owner of a particular Canadian mining property, the proceeds of disposition with respect to that property are applied to reduce the successored CCDE balance in respect of the first original owner before any unapplied portion of the proceeds are used to reduce the successored CCDE balances in respect of subsequent original owners. (If any portion of the proceeds still remains unapplied, such portion effectively reduces the taxpayer's own CCDE pursuant to the amended description of F of the CCDE definition in subsection 66.2(5) of the Act.)

Subparagraph 66.7(4)(a)(iii) of the Act is introduced so that, in computing a taxpayer's successor CCDE balance in respect of an original owner, there is deducted a portion of designated proceeds that become receivable after 1992 from the disposition of Canadian oil and gas property formerly owned by the original owner. The amount so deducted does not include amounts deducted in computing a successor CCOGPE balance in respect of the original owner or amounts deducted in computing a successor CCOGPE or CCDE balance in respect of a prior original owner. The designation of the proceeds must be made in prescribed form by the taxpayer (or the predecessor owner who received such proceeds) within 6 months after the end of the taxation year in which the proceeds become receivable or by the end of the sixth month after the end of the taxpayer's taxation year in which Royal Assent to this amendment occurs, whichever is later. A taxpayer may find it advantageous to designate an amount under new subparagraph 66.7(4)(a)(iii) in order to minimize (by virtue of new paragraph (c) of the description of F in the CCOGPE definition in subsection 66.4(5)) a reduction of the taxpayer's own CCOGPE.

These amendments apply to taxation years ending after February 17, 1987. The examples below illustrate the operation of the amendments to the description of F of the CCDE definition and subparagraph 66.7(4)(a)(ii).

EXAMPLE 1

Properties A, B, C and D are Canadian mining properties owned by S. O1 is an original owner of properties A and B which were acquired by O2 in a successor transaction. O2 is an original owner of properties A, B and C which were acquired by O3 in a successor transaction. O3 is an original owner of properties A, B, C and D which were acquired by S in a successor transaction. S disposes of properties B, C and D in a non-successor transaction. Immediately before the latest disposition, the successor CCDE balances were $1,000, $2,400 and $3,800 (Total = $7,200) in respect of O1, O2 and O3, respectively. The proceeds that became receivable by S were $4,000, $2,300 and $200 (Total = $6,500) for properties B, C and D, respectively.

Result:

1. The O1 successor CCDE balance is reduced to nil ($1,000 - $4,000). The O2 successor CCDE balance is reduced to nil ($2,400 - ($2,300 + $4,000 - $1,000)). The O3 successor CCDE balance is reduced to $700 ($3,800 - ($200 + $2,300 + $4,000 - $2,400 - $1,000)). In calculating the O2 successor CCDE balance, the portion ($1,000) of the proceeds reducing the O1 successor CCDE balance is added back. Likewise, in calculating the O3 successor CCDE balance, the portions ($1,000 and $2,400) of the proceeds reducing the O1 and O2 successor CCDE balances are also added back. The O3 successor CCDE balance of $700 after the disposition may be deducted by S against streamed income from property A.

2. S's own CCDE pool is not affected because of the offsets provided under paragraph (b) of the calculation of the value of F in the CCDE definition in subsection 66.2(5). For a more detailed analysis of these offsets, see Example 2.

EXAMPLE 2

Same facts as in example 1, except that the proceeds receivable by S for properties B, C and D are $6,800, $11,000 and $2,000 (Total = $19,800), respectively.

Result:

1. In this case, following the method in example 1, the O1, O2 and O3 successor CCDE balances are reduced to nil.

2. The total reduction in the successor CCDE balances is $7,200. Therefore, as a result of the description of F in the CCDE definition, the total reduction in the taxpayer's own CCDE in respect of the disposition is $12,600 ($19,800 - $7,200).

EXAMPLE 3

Same facts as in example 1, except that the proceeds receivable by S for properties B, C and D are $1,200, $800 and $12,000 (Total = $14,000), respectively.

Result:

1. The O1 successor CCDE balance is reduced to nil. ($1,000 - $1,200). The O2 successor CCDE balance is reduced to $1,400 ($2,400 - ($1,200 + $800 - $1,000)). The O3 successor CCDE balance is reduced to nil ($3,800 - ($1,200 + $800 + $12,000 - $1,000 - $1,000)). For further discussion on this calculation, see example 1.

2. The total reduction in the successor CCDE balances is $5,800 ($7,200 - $1,400). Therefore, as a result of the description of F in the CCDE definition, the total reduction in the taxpayer's own CCDE in respect of the disposition is $8,200 ($14,000 - $5,800).

Subclause 31(3)

ITA
66.7(5)(a)(ii)

Subsection 66.7(5) of the Act provides a deduction for a taxpayer in respect of the taxpayer's successored CCOGPE balances in respect of original owners. Deductions under this subsection are determined on a property-by-property basis. A deduction with respect to a particular property may be claimed by a taxpayer equal to the total specified amounts determined with respect to original owners of the particular property. A specified amount determined in respect of an original owner and a particular property is, in general terms, the lesser of:

- 10% of the taxpayer's successored CCOGPE balance in respect of the original owner (or, more specifically, 10% of the amount, if any, by which the undeducted CCOGPE in respect of the original owner exceeds, where the particular property is Canadian oil and gas property, proceeds of disposition for the particular property that had become receivable by the taxpayer or a predecessor owner), and

- income from the production of the particular property, computed without reference to resource deduction provisions in the Act.

In determining the above amounts, no part of a successor CCOGPE balance may be deducted more than once (subclauses 66.7(5)(a)(i)(A) to (A.1)), nor can particular amounts of streamed income be used more than once as the basis for deduction under section 66.7 (subparagraph 66.7(5)(b)(ii) and parallel provisions in subsections 66.7(1), (3) and (4)).

Subparagraph 66.7(5)(a)(ii) is amended to ensure that, in computing a successor CCOGPE balance in respect of an original owner in respect of a particular property, there are deducted other proceeds of disposition with respect to other Canadian oil or gas property owned by the original owner before being acquired with the particular property by a successor to the original owner.

Subparagraph 66.7(5)(a)(ii) is also amended so that the proceeds of disposition with respect to successored Canadian oil and gas property are applied to reduce the successored CCOGPE balance in respect of the first original owner of that property before any unapplied portion of the proceeds are used (to the extent provided in new subparagraph 66.7(4)(b)(iii)) to reduce successor CCDE balance in respect of the first original owner. If any unapplied proceeds remain, the successor CCOGPE and CCDE balances in respect of any other original owners are likewise adjusted in the order that they become predecessor owners in respect of the successor. (If any portion of the proceeds still remains unapplied, such portion effectively reduces the taxpayer's own CCOGPE pursuant to the amended description of F of the CCOGPE definition.

These amendments apply to taxation years ending after February 17, 1987. The example below illustrates the effect of the amendments to this subparagraph, the description of F of the CCOGPE definition, the descriptions of F and L of the CCDE definition and the introduction of subparagraph 66.7(4)(a)(iii).

EXAMPLE 4

Properties A, B, C and D are Canadian oil and gas properties owned by S. O1 is an original owner of properties A and B which were acquired by O2 in a successor transaction. O2 is an original owner of properties A, B and C which were acquired by O3 in a successor transaction. O3 is an original owner of properties A, B, C and D which were acquired by S in a successor transaction. S disposes of properties B, C and D in 1993 in a non-successor transaction. Immediately before the latest disposition, the successor CCOGPE balances were $1,000, $2,400 and $3,800 (Total = $7,200) in respect of O1, O2 and O3, respectively. In addition, the taxpayer has successor CCDE balances of $4,000 in respect of O1 and $20,000 in respect of O2. The proceeds that became receivable by S were $6,800, $11,000 and $7,000 (Total = $24,800) for properties B, C and D, respectively. S designates proceeds to the full extent possible under subparagraph 66.7(4)(a)(iii).

Result:

1. The O1 successor CCOGPE balance is nil (1,000 - (6,800)). The O1 successor CCDE balance is nil (4,000 - (6,800 - 1,000)). The O2 successor CCOGPE balance is nil (2,400 - (6,800 + 11,000 - 1,000 - 4,000)). The O2 successor CCDE balance is $9,600 (20,000 - (6,800 + 11,000 - 1,000 - 4,000 - 2,400)). The O3 successor CCOGPE balance is nil. (3,800 - (6,800 + 11,000 + 7,000 - 1,000 - 4,000 - 2,400 - (20,000 -9,600)). These calculations are made in the same manner as the calculations made in the first example to the commentary on paragraph 66.7(4)(a).

2. The total reduction in the successor CCOGPE balances is therefore $7,200. The total reduction in the successor CCDE balances resulting from the disposition of the properties is $14,400. Therefore, under the calculation of the value of F in the CCOGPE definition, the total reduction in the taxpayer's own CCOGPE in respect of the disposition is $3,200 (24,800 - 7,200 - 14,400).

3. No offset to the amount determined under the calculation of the value of L in the CCDE definition results because the proceeds became receivable by the taxpayer after 1992.

Subclause 31(4)

ITA
66.7(14)

Subsection 66.7(14) of the Act applies to a successor corporation which disposes of Canadian resource properties to a subsequent successor. For the purposes of determining the first successor's deductions under section 66.7 (or subsection 29(25) of the *Income Tax Application Rules*) with respect to its acquisition of any of those properties, it is generally deemed never to have acquired those properties. However, it is entitled to claim deductions under subsection 66.7(1) (dealing with an original owner's Canadian exploration and development expenses) and subsection 66.7(3) (dealing with an original owner's Canadian exploration expenses) for the taxation year of the disposition. In the case of arm's length dispositions or dispositions by way of amalgamation or merger, it is also allowed to claim deductions under subsections 66.7(4) and (5) (dealing with an original owner's Canadian development expenses and Canadian oil and gas property expenses, respectively) for the taxation year of the disposition.

Subsection 66.7(14) is amended to clarify that it applies for the purposes of determining successor deductions with respect to Canadian resource property retained by a successor corporation at the time of a disposition to which the successor rules apply. This ensures that no successor deductions under the above-referenced subsections may be claimed in respect of such retained property for taxation years commencing after the successor has disposed of substantially all of its Canadian resource property in circumstances to which the successor rules apply.

Subsection 66.7(14) is also amended to clarify that it does not apply for the purposes of the amended description of F in the CCDE definition, amended paragraphs (a) and (b) of the description of L in the CCDE definition and the amended description of F in the CCOGPE definition. These provisions require that a taxpayer's CCDE or CCOGPE be determined at specified times with reference to subsections 66.7(4) and (5). In the absence of this measure, it is arguable that the benefit provided to a taxpayer by virtue of those provisions would be automatically eliminated after a succession.

Subsection 66.7(14) is also amended to ensure that, where a successor corporation retains Canadian resource property on a disposition of other Canadian resource properties in circumstances to which the successor rules apply, the corporation which acquires the other property (or subsequent successors) will not be required to reduce its successored CCDE or CCOGPE balances by virtue of a disposition of the retained property by the first successor corporation.

These amendments apply to dispositions occurring in taxation years ending after February 17, 1987.

ITA
66.7(15)

Subsection 66.7(15) of the Act applies to a successor corporation which disposes of foreign resource properties to a subsequent successor. For the purposes of determining the first successor's deductions under subsection 66.7(2) with respect to its acquisition of any of those properties, it is deemed never to have acquired those properties.

Subsection 66.7(15) is amended to clarify that it applies for the purposes of determining successor deductions with respect to foreign resource property retained by a successor corporation at the time of a disposition to which the successor rules apply. This ensures that no successor deductions under subsection 66.7(2) may be claimed in respect of such retained property for taxation years ending after the successor has disposed of foreign resource property in circumstances to which the successor rules apply.

This amendment applies to taxation years ending after February 17, 1987.

Clause 32

Shareholder Appropriations

ITA
69(4)

Subsection 69(4) of the Act provides that, where property of a corporation has been appropriated by a shareholder for no consideration or for consideration below its fair market value and a sale of the property at fair market value would have increased the corporation's income for the year, the corporation will be considered to have sold the property during the year and received proceeds equal to the property's fair market value.

Subsection 69(4) is amended to also apply where property of a corporation is appropriated by a shareholder of the corporation for no consideration or for consideration below its fair market value and a sale of the property would have reduced a loss of the corporation. In such circumstances, the corporation will be considered to have disposed of the appropriated property and to have received proceeds of disposition equal to the fair market value of the property.

This amendment applies to appropriations occurring after December 21, 1992.

Clause 33

Death of a Taxpayer

ITA
70

Section 70 of the Act provides certain rules that apply upon the death of a taxpayer.

Subclause 33(1)

ITA
70(3.1)

Under subsection 70(2) of the Act, the value of certain "rights or things" owned by a taxpayer at death is required to be included in the taxpayer's income for the year of death. Subsection 70(3) provides that this rule does not apply in connection with "rights or things" transferred to beneficiaries of the deceased within a specified time. Subsection 70(3.1) provides that certain property, including an interest in a life insurance policy (other than an annuity contract, where the payment for the contract was deductible under paragraph 60(l) of the Act) does not constitute a "right or thing" for this purpose.

Subsection 70(3.1) is amended so that a "right or thing" includes an annuity contract acquired in circumstances to which new subsection 146(21) of the Act applies. As described below, the latter subsection allows the transfer of amounts from prescribed provincial pension plans to acquire annuities described in paragraph 60(l).

This amendment applies to the 1992 and subsequent taxation years.

Subclause 33(2)

ITA
70(5)

Subsection 70(5) of the Act provides for the deemed realization of capital property owned by a taxpayer immediately before the death of the taxpayer.

ITA
70(5)(a) and (b)

Paragraph 70(5)(a) of the Act treats a deceased taxpayer as having disposed of each capital property owned immediately before death for proceeds equal to the fair market value of the property at that time.

Paragraph 70(5)(a) is amended to clarify that a deceased taxpayer is considered to have received the proceeds of disposition immediately before death.

Paragraph 70(5(b) of the Act provides that a person who acquires capital property as a consequence of a taxpayer's death is deemed to acquire the property at a cost equal to its fair market value. Paragraph 70(5)(b) is amended to clarify that, in such a case, the acquisition of the property is deemed to take place at the time of the taxpayer's death, and the cost of the property to the person acquiring it is deemed to be the fair market value of the property immediately before the death.

These amendments to paragraphs 70(5)(a) and (b), which are not intended to change the time at which a deceased taxpayer is considered to receive proceeds of disposition nor the time at which a person is considered to acquire capital property from a deceased taxpayer, apply to dispositions and acquisitions occurring after 1992.

ITA
70(5)(c) and (d)

Paragraph 70(5)(c) of the Act sets out special rules that may apply to a person acquiring a depreciable property of a prescribed class as a consequence of the death of a taxpayer. In the event that the capital cost of the deceased taxpayer's property exceeds the cost (as determined under paragraph 70(5)(b)) of the property to the person acquiring it, for the purposes of the capital cost allowance regulations and the rules concerning recapture and terminal loss, the capital cost of the property to the person is deemed to be the amount that was the capital cost to the deceased taxpayer of the property. Further, the amount by which that capital cost exceeds the cost to the person is considered to have been deducted by the person as capital cost allowance in respect of the property in previous taxation years.

Paragraph 70(5)(c) is amended to exclude from its application circumstances in which the deceased taxpayer's proceeds of disposition under paragraph 70(5)(a) are redetermined under subsection 13(21.1) of the Act. Subsection 13(21.1) provides that, where a building and land on which it is located are disposed of, a terminal loss on the sale of the building is reduced to the extent of any gain on the sale of the land. This is achieved by increasing the proceeds of disposition in respect of the building by the lesser of the amount of the terminal loss on the building and the gain on the sale of the land. The capital gain on the disposition of the land is then reduced by a corresponding amount. In such circumstances, new paragraph 70(5)(d) of the Act applies.

Under new paragraph 70(5)(d), separate rules apply where the amount that was a deceased taxpayer's proceeds of disposition in respect of a property are redetermined under subsection 13(21.1). Where a building had a capital cost to the deceased taxpayer that exceeds the amount determined under subsection 13(21.1) to be the deceased taxpayer's proceeds of disposition, the capital cost of the building to the person acquiring it is treated as being the amount that was the capital cost of the building to the deceased taxpayer. The amount by which the deceased taxpayer's capital cost of the building exceeds the deceased taxpayer's proceeds of disposition, rather than the cost of the building to the person acquiring it, is deemed to have been deducted by the person acquiring the building as capital cost allowance on the building in computing income for previous taxation years. Finally, the cost to the person of the land is deemed to be the amount that was the deceased taxpayer's proceeds of disposition in respect of the land under subsection 13(21.1).

These amendments, like the amendments to paragraphs 70(5)(a) and (b) of the Act, apply to dispositions and acquisitions occurring after 1992.

EXAMPLE

- A taxpayer owns, immediately before death, a building and contiguous land that is used for income earning purposes.

- The relevant values are:

	ACB/CC	UCC	FMV	CG	Term. Loss
Land	$ 20,000	N/A	$50,000	$30,000	N/A
Building	$100,000	$20,000	NIL	--	$20,000

Subsection 13(21.1) applies to reallocate the proceeds of disposition between the land and building -- the land's proceeds of disposition are reduced by $20,000 (the amount of the deceased taxpayer's terminal loss otherwise determined) and the building's proceeds of disposition are increased by an equivalent amount. Thus the proceeds of disposition of the building will be $20,000 and of the land $30,000, producing a capital gain of $10,000 and a terminal loss of nil respectively.

By reason of the application of amended paragraph 70(5)(d) the person acquiring the property will be considered to have acquired the land at a cost of $30,000, rather than $50,000. Moreover, the building will be deemed to have been acquired by that person at a capital cost of $100,000, rather than nil and the person will be treated as having claimed capital cost allowance of $80,000, rather than $100,000, in previous years.

Subclauses 33(3) and (4)

ITA
70(5.1)(b) and (c)

Subsection 70(5.1) of the Act provides a tax deferral where, as a consequence of a taxpayer's death, a person (other than the deceased taxpayer's spouse or a corporation controlled by the deceased taxpayer) has acquired eligible capital property of the taxpayer.

Paragraph 70(5.1)(b) is amended to clarify that, subject to paragraph (70)(5.1)(c) of the Act, the taxpayer's beneficiary in such a case is considered to have acquired a capital property at the time of the taxpayer's death. Paragraph 70(5.1)(c), which applies where the beneficiary continues to carry on the business previously carried on by the taxpayer, is amended to clarify that the beneficiary is considered to have acquired an eligible capital property and to have made an eligible capital expenditure at the time of the taxpayer's death.

These amendments, which are not intended to change the time at which a beneficiary is considered to have acquired a taxpayer's eligible capital property, apply to acquisitions of property occurring after 1992.

Subclause 33(5)

ITA
70(5.2)

Subsection 70(5.2) of the Act provides rules with respect to the disposition of resource properties and land inventories on death.

Subsection 70(5.2) is amended to clarify that a deceased taxpayer, who is deemed to have disposed of such property immediately before death for an amount equal to the fair market value of the property at that time, is also considered to have received proceeds of disposition at that time. Similarly, where the property is acquired on a tax deferred basis by the person's spouse or by a spousal trust, the spouse or trust, as the case may be, is deemed to have acquired the property at the time of the person's death.

This amendment, which is not intended to change the time at which the deceased person is considered to have received proceeds of disposition or the time at which a spouse (or spousal trust) acquires the property, applies to dispositions and acquisitions of property occurring after 1992.

Subclause 33(6)

ITA
70(6)(d)

Subsection 70(6) of the Act provides that, among other matters, where depreciable property is transferred or distributed as a consequence of the death of a taxpayer to certain individuals, the proceeds of disposition are treated as being equal to an amount that is intended to ensure that the property is transferred on a tax-deferred ("rollover") basis.

Previously, the deceased taxpayer's proceeds of disposition in respect of a particular depreciable property were computed under subparagraph 70(6)(d)(i) to be equal to the product of multiplying the undepreciated capital cost of the class of property by the fraction that is the fair market value of the particular property over the fair market value of all of the property in the class.

Subparagraph 70(6)(d)(i) is amended to provide that, with respect to depreciable property of a prescribed class, a deceased taxpayer's proceeds of disposition are equal to the lesser of the "capital cost" and the "cost amount" to the taxpayer of the property immediately before the taxpayer's death.

Notwithstanding an intended "rollover" treatment, the application of the former formula in subparagraph 70(6)(d)(i) to the disposition of depreciable property of a prescribed class could result in unintended capital gains and terminal losses. The use of "capital cost" in amended subparagraph 70(6)(d)(i) ensures that the proceeds of disposition in respect of a depreciable property of a prescribed class do not create a capital gain to the deceased by exceeding the "capital cost" of the transferred property. This result could otherwise occur, for example, where the undepreciated capital cost (UCC) of the class of property exceeds the capital cost of the property remaining in the class immediately before the time of death. Similarly, the recipient of a property cannot acquire the property at a "cost" that may otherwise exceed its capital cost to the deceased. Further, it should be noted that new subsection 70(13) provides that the capital cost of a deceased taxpayer's depreciable property equals the amount that would be the capital cost to the taxpayer of the property immediately before the time of death if certain limitations in subsection 13(7) of the Act did not apply to the property. Generally, these limitations lower the capital cost of certain property for capital cost allowance (CCA) purposes, rather than for capital gains or capital loss purposes. Reference should also be made to new subsection 70(14) of the Act, which contains an ordering provision that applies to the disposition of two or more properties held in the same prescribed class.

Subsection 248(1) of the Act provides, generally, that the "cost amount" of depreciable property is to be computed by multiplying the UCC of the class by the proportion that is the capital cost of the transferred property divided by the capital cost of all of the property of the class not disposed of before the time of computation.

The effect of this amendment is that capital gains and, generally, terminal losses, are deferred where subparagraph 70(6)(d)(i) applies to property of a deceased taxpayer. However, terminal losses will arise with respect to the amount by which, immediately before the death of the taxpayer, the UCC of the class of property exceeds the capital cost of all of the property in the class at that time.

This amendment applies to dispositions occurring after 1992.

Subclause 33(7)

ITA
70(6)(d.1)

Paragraph 70(6)(d.1) of the Act provides that where an interest in a partnership (other than an interest to which subsection 100(3) of the Act applies) is transferred as a consequence of a taxpayer's death, the taxpayer will be treated (except for the purposes of paragraph 98(5)(g) of the Act) as not having disposed of the interest immediately before death. The transferee is treated as having acquired the interest at its cost to the taxpayer.

Subparagraph 70(6)(d.1)(ii) is amended to clarify that a transferee who acquires a deceased taxpayer's partnership interest does so at the time of the taxpayer's death. This amendment, which applies after 1992, is not intended to change the time at which a person is considered to have acquired a deceased taxpayer's partnership interest.

Subclause 33(8)

ITA
70(9)

Subsection 70(9) of the Act provides for a tax-deferred rollover on intergenerational transfers of certain farm property from a taxpayer to a child of the taxpayer as a result of the death of the taxpayer. In this regard, the deceased taxpayer's proceeds of disposition are treated as being equal to an amount that is intended to ensure that the property is transferred on a rollover basis to a child of the deceased taxpayer. An election is, however, provided that allows the legal representative of the taxpayer to elect out of the rollover provision.

Subsection 70(9) is amended in four respects. First, the subsection is amended to clarify the time at which a deceased taxpayer is deemed to dispose of and receive proceeds for such property and the time at which the cost of the property to a person acquiring it is to be determined. (For further information, see the commentary on the amendments to paragraphs 70(5)(a) and (b) of the Act.) This amendment is not intended to change the time at which a deceased taxpayer is considered to have received proceeds of disposition in respect of transferred property nor the time at which a taxpayer's child acquires the property.

Second, the formula used in subparagraph 70(9)(b)(i) to determine a deceased taxpayer's proceeds of disposition, with respect to the rollover of depreciable property of a prescribed class, is amended to provide that the proceeds of disposition of such depreciable property will be the lesser of the "capital cost" and the "cost amount" to the taxpayer of the property immediately before the taxpayer's death. For additional details, see the commentary accompanying the amendment to subparagraph 70(6)(b)(i). Also, see related amendments to subsections 70(9.1) and new subsections 70(13) and (14).

Third, subparagraph 70(9)(b)(ii) is amended to ensure that only subparagraph 70(9)(b)(i) applies to land that is depreciable property of a prescribed class (e.g., land that is described in subsection 13(5.2) of the Act).

Fourth, paragraph 70(9)(c) is amended to add a reference to new paragraph 70(5)(d). This amendment ensures that either the rule described in paragraph 70(5)(c) or (d) applies where the legal representative of the deceased taxpayer elects to recognize proceeds of disposition that do not provide for a rollover of property. In such circumstances, subsection 13(21.1) may apply to redetermine the proceeds of disposition. For additional details, see the commentary accompanying the amendments to subsection 70(5) of the Act.

These amendments apply to dispositions and acquisitions occurring after 1992.

Subclause 33(9)

ITA
70(9.1)

Subsection 70(9.1) of the Act provides rules for allowing a tax-deferred transfer ("roll-out") on intergenerational transfers of farm property from certain trusts to a child of a taxpayer as a consequence of the death of the taxpayer's spouse. The trust's proceeds of disposition are treated as being equal to an amount that is intended to ensure that the property is transferred on a rollover basis to the child. An election is, however, provided that allows the trust to elect out of the rollover provision.

Subsection 70(9.1) is amended in four respects. First, the subsection is amended to clarify the time at which a trust is deemed to dispose of and receive proceeds for such property and the time at which the cost of the property to a person acquiring it is to be determined. (For further information, see the commentary on the amendments to paragraphs 70(5)(a) and (b) of the Act.) This amendment is not intended to change the time at which a trust is considered to have received proceeds of disposition in respect of transferred property nor the time at which a taxpayer's child acquires the property.

Second, the formula in subparagraph 70(9.1)(b)(i), which determines the trust's proceeds of disposition with respect to depreciable property of a prescribed class, is amended to ensure that a rollover to a child of the taxpayer results on the death of the taxpayer's spouse unless an election is filed by the trust. In particular, that subparagraph is amended to provide that the trust's proceeds of disposition with respect to depreciable property of a prescribed class are the lesser of the "capital cost" and the "cost amount" to the trust of the property immediately before the spouse's death. A corresponding amendment is also made with respect to the replacement paragraph for paragraph 70(9.1)(b), which applies when an election is made by the trust. For additional details, see the commentary on the amendment to subsection 70(6).

Third, subparagraph 70(9.1)(b)(ii) is amended to ensure that only subparagraph 70(9.1)(b)(i) applies to land that is depreciable property of a prescribed class (e.g., land that is described in subsection 13(5.2) of the Act).

Fourth, paragraph 70(9.1)(c) is amended so that new paragraph 70(9.1)(d) applies where the trust's proceeds of disposition under paragraph 70(9.1)(b) are redetermined under subsection 13(21.1) of the Act. For further information, see the commentary on amended subsection 70(5) of the Act.

These amendments apply to dispositions and acquisitions occurring after 1992.

Subclause 33(10)

ITA
70(9.2)

Subsection 70(9.2) of the Act sets out certain rules that apply to the transfer of a share of a family farm corporation or an interest in a family farm partnership on the death of a taxpayer where the transfer is to a child of the taxpayer.

Subsection 70(9.2) is amended to clarify the time at which a deceased taxpayer is deemed to dispose of and receive proceeds for such property and the time at which the cost of the property to a person acquiring it is to be determined. (For further information, see the commentary on the amendments to paragraphs 70(5)(a) and (b) of the Act.) This amendment, which is not intended to change the time at which a deceased taxpayer is considered to have received proceeds of disposition in respect of transferred property nor the time at which a taxpayer's child acquires the property, applies to dispositions and acquisitions of property occurring after 1992.

Subclause 33(11)

ITA
70(13)

New subsection 70(13) of the Act provides that certain adjustments previously made to the capital cost of depreciable property of a prescribed class under subsection 13(7) of the Act do not apply for the purposes of section 70. Therefore, the capital cost to a deceased taxpayer of such depreciable property is to be readjusted for the purposes of determining the proceeds of disposition of that property in amended paragraphs 70(6)(d), (9)(b) and (9.1)(b). This readjusted capital cost is to used for the purposes of determining both the undepreciated capital cost (UCC) of the class and the amount by which the UCC is to be reduced as a result of a disposition, but is not to be used for the purposes of determining any claim for capital cost allowance made on behalf of a deceased taxpayer.

This amendment applies to dispositions occurring after 1992.

ITA
70(14)

New subsection 70(14) of the Act, which applies to dispositions occurring after 1992, generally provides that, where two or more depreciable properties of a prescribed class are disposed of as a consequence of the death of a taxpayer, section 70 and paragraph (a) of the definition of "cost amount" in subsection 248(1) of the Act apply as if each property were disposed of in the order designated by the taxpayer's legal representative or, in the case of a trust to which subsection (9.1) applies, by the trust. Where no such designation is filed in the appropriate tax return, the order designated by the Minister of National Revenue will apply.

Clause 34

***Inter vivos* Transfers of Property**

ITA
73(1.1)

Subsection 73(1.1) of the Act provides greater certainty that the rollover rules in subsection 73(1) of the Act apply on the transfer by a taxpayer of property to the taxpayer's spouse or former spouse or to a trust established on that person's behalf by operation of certain prescribed provincial laws or court orders made in accordance with such laws. Subsection 73(1.1) is amended to refer to transfers made under the laws of a province in order to conform with the language in subsection 73(1) of the Act. This amendment applies to transfers that occur after July 13, 1990.

Clause 35

Deemed Dividends

ITA 84

Section 84 of the Act provides that certain transactions involving the shares of a corporation will be treated as producing dividends for tax purposes.

Subclause 35(1)

ITA
84(1)(c.3)

Subsection 84(1) of the Act treats a dividend as having been paid by a corporation on the shares of a class of its capital stock where the paid-up capital of the class is increased by the corporation in circumstances other than those set out in that subsection.

Subparagraph 84(1)(c.3)(iii) of the Act enables a corporation to convert to paid-up capital, without triggering a deemed dividend, contributed surplus that arose on a previous reduction of paid-up capital. This provision is amended to clarify that the amount of contributed surplus that can be so converted cannot exceed the amount by which the paid-up capital, as defined in subsection 89(1) of the Act, was previously reduced. This amendment applies to actions taken after December 20, 1992 to convert contributed surplus to paid-up capital. In addition, subclause 35(3) of the legislation clarifies the date of the coming-into-force of a previous amendment to paragraph 84(1)(c.3).

Subclause 35(2)

ITA
84(11)

Subparagraph 84(1)(c.3)(ii) of the Act enables a corporation to convert to paid-up capital, without triggering a deemed dividend, contributed surplus that arose in circumstances where a shareholder transferred property to a corporation for no consideration or for consideration that did not include shares of the corporation. New subsection 84(11) of the Act limits, for the purposes of subparagraph 84(1)(c.3)(ii), the amount of contributed surplus that can be considered to have arisen on a contribution of shares to a corporation in certain circumstances. This limitation is intended to ensure that a person cannot circumvent the anti-surplus stripping rules in sections 84.1 and 212.1 of the Act. Where shares of a corporation resident in Canada are contributed to the corporation and, immediately thereafter, the two corporations are connected within the meaning of subsection 186(4) of the Act, the contributed surplus that, for the purposes of subparagraph 84(1)(c.3)(ii), could be considered to have arisen on the acquisition of the contributed shares will be the lesser of

- the amount actually added to contributed surplus, and

- the paid-up capital of the contributed shares less the value of any consideration given for the contributed shares.

New subsection 84(11) of the Act applies to actions after December 20, 1992 to convert contributed surplus into paid-up capital.

Clause 36

Transfers of Property to a Corporation

ITA
85

Section 85 of the Act provides rules that apply where a taxpayer or a partnership transfers certain property to a corporation.

Subclause 36(1)

ITA
85(1)(d.1)

Subsection 85(1) of the Act allows a transfer on a tax-deferred basis of certain properties by a taxpayer to a taxable Canadian corporation in exchange for shares. This treatment is available where the taxpayer and the corporation jointly elect. Paragraph 85(1)(d.1) is intended to prevent an overstatement of the amount to be included, under paragraph 14(1)(b) of the Act, in computing the income of a corporation as a result of a disposition of eligible capital property, where the property had previously been transferred to the corporation and an election had been made under subsection 85(1) in respect of that transfer.

These amendments to paragraph 85(1)(d.1) are intended to ensure that the correct amount is included in the income of a corporation under paragraph 14(1)(b) in circumstances where the amount elected in respect of the eligible capital property exceeds 4/3 of the cumulative eligible capital of the transferee's business immediately before the transfer to the corporation.

These amendments apply to dispositions of property to a corporation that occur after the beginning of the first taxation year of the corporation beginning after June 1988.

Subclause 36(2)

ITA
85(2.1)

Subsection 85(2.1) of the Act provide rules for computing the paid-up capital of a class of shares of the capital stock of a corporation that has issued shares as consideration for property in a transaction to which subsection 85(1) applies.

Where shares issued by the transferee in consideration for the property are issued at the time of, rather than after, the disposition of the property, there may be a momentary increase in paid-up capital since the rules in subsection 85(2.1) currently provide for a reduction in determining the paid-up capital of a class of shares at any time after the disposition of the property. Where the transferred property is a share of the transferee corporation having a paid-up capital that is less than the stated capital for corporate purposes of the share issued in consideration therefor, the momentary increase in paid-up capital may give rise to a deemed dividend under subsection 84(1) or (3). Subsection 85(2.1) is amended, applicable to dispositions of property occurring after November 21, 1985, to ensure that it applies not only after, but also at, the time of such a disposition. As a result, the reduction in paid-up capital under subsection 85(2.1) will be taken into account in determining the amount of any deemed dividend arising under subsection 84(1) or (3) of the Act in respect of the same transaction.

Subclause 36(3)

ITA
85(4)(b)

Subsection 85(4) of the Act applies where a taxpayer disposes of capital property or eligible capital property to a corporation that is controlled by the taxpayer, the taxpayer's spouse or a person or group of persons by whom the taxpayer is controlled. Paragraph 85(4)(a) applies in these circumstances to deny to the taxpayer any capital loss or deduction under paragraph 24(1)(a) of the Act that would otherwise arise from the disposition. Where the taxpayer owns shares of the corporation, the denied loss is added to the adjusted cost base of those shares.

Paragraph 85(4)(b) is amended to delete the reference to "4/3" in the calculation of the amount of any such loss to be added back to the adjusted cost base of shares in respect of eligible capital property. This amendment is consequential on a previously enacted amendment to the definition of "cost amount" in subsection 248(1) of the Act, so that the 4/3 gross-up of the cumulative eligible capital of a taxpayer in respect of a business is now provided under subsection 248(1).

This amendment applies to dispositions of property by a corporation after the beginning of the corporation's first taxation year that begins after June 1988, and to dispositions of property by other taxpayers after the beginning of a business's first fiscal period that begins after 1987.

Clause 37

Share-for-Share Exchanges

ITA
85.1(2)

Section 85.1 of the Act provides a tax deferred rollover for shareholders who exchange shares of a corporation (the "acquired corporation") for shares of the purchasing Canadian corporation in the course of an arm's length sale of the acquired corporations' shares.

Paragraph 251(5)(b) of the Act provides that a taxpayer who has a right under a contract to acquire shares of a corporation will be considered to be in the same position in relation to the control of the corporation as if the taxpayer owned the shares. Because a share-for-share exchange agreement is a contract to acquire shares within the meaning of paragraph 251(5)(b), both parties to the agreement could be considered to control the acquired corporation immediately before the share exchange, and therefore would not be considered to be dealing at arm's length with each other. As a result, the tax deferred rollover provided by subsection 85.1(1) of the Act would not apply.

This amendment to subsection 85.1(2) of the Act, which applies to exchanges occurring after December 21, 1992, provides that, for the purposes of the rollover provided in subsection 85.1(1), a share-for-share exchange agreement will not create a non-arm's length relationship between the parties to the agreement.

Clause 38

Reduction in Paid-Up Capital

ITA
86

Section 86 of the Act provides a deferral of tax for a shareholder who, in the course of a reorganization of the capital of a corporation, disposes of all of the shareholder's shares of a class for consideration that includes other shares of the corporation. Such an exchange of shares may, however, result in the shareholder being deemed by section 84 of the Act to have received a dividend where the stated capital of the old shares exceeds their paid-up capital for tax purposes. Such a paid-up capital deficiency could arise, for example, where subsection 85(2.1) of the Act applies to reduce the paid-up capital of a class of shares as a consequence of a previous transfer of property to which subsection 85(1) applied.

Subclause 38(1)

ITA
86(2.1)

New subsection 86(2.1) of the Act reduces the paid-up capital of the classes of shares received on an exchange described above. The effect of the reduction is to permit the paid-up capital deficiency of the old shares to flow through to the new shares received on the exchange, thereby ensuring that the exchange will not result in any increase in paid-up capital to which subsection 84(1) of the Act could apply and that the amount received for the old shares for purposes of subsection 84(3), having regard to subsection 84(5), will be equal to the paid-up capital of the old shares plus the amount of the non-share consideration received on the exchange in excess of the paid-up capital of the old shares. New subsection 86(2.1) applies to share exchanges occurring after December 20, 1992 and, unless the corporation elects within a certain time limit not to have it apply, to share exchanges occurring after August 1992 and before December 21, 1992.

Subclause 38(2)

ITA
86(3)

Subsection 86(3) of the Act is amended, as a consequence of the amendments to section 51 of the Act, to change the ordering of the application of the rollover provisions in sections 51 and 86. Under the existing rules, section 86 of the Act does not apply if section 51 could apply. Under the amended rules, section 51 will not apply where section 86 applies. The amendment to subsection 86(3) applies to reorganizations of capital commencing after December 21, 1992.

Clause 39

Amalgamations

ITA
87

Section 87 of the Act provides rules that apply on the amalgamation of two or more taxable Canadian corporations.

Subclauses 39(1) and (2)

ITA
87(1.2) and (1.4)

Where there has been an amalgamation of two or more corporations, the successor rules in section 66.7 of the Act generally provide that unclaimed resource expenditures of a predecessor corporation may be deducted by the new corporation only within the limitations of the successor rules (i.e., against "streamed income" related to the predecessor corporation's resource properties). However, under subsection 87(1.2) the successor rules do not apply where there has been an amalgamation of a corporation and one or more of its "subsidiary wholly-owned corporations" or an amalgamation of two or more corporations which are "subsidiary wholly-owned corporations" of the same corporation. Under subsection 87(1.4) of the existing Act, a "subsidiary wholly-owned corporation" of another corporation is a corporation all the issued and outstanding shares of which belong to the other corporation (or to another "subsidiary wholly-owned corporation" of the other corporation).

Subsection 87(1.2) is extended so that the amalgamation of two or more subsidiary wholly-owned corporations of the same individual also does not result in the application of the successor rules. Amended subsection 87(1.4) provides that a "subsidiary wholly-owned corporation" of an individual is a corporation all the issued and outstanding shares of which belong to the individual (or to another "subsidiary wholly-owned corporation" of that individual).

This amendment applies to amalgamations occurring after December 21, 1992.

Subclause 39(3)

ITA
87(2)(j.3)

Paragraph 87(2)(j.3) of the Act provides that a corporation formed as the result of an amalgamation is considered to be a continuation of its predecessor corporations for the purposes of a number of provisions in the Act relating to employee benefit plans (EBPs), salary deferral arrangements (SDAs) and retirement compensation arrangements (RCAs). Paragraph 87(2)(j.3) is amended by adding references to paragraph 12(1)(n.1) (income inclusion for amounts received by an employer from an EBP) and paragraph 104(13)(b) (income inclusion for income distributed by a trust governed by an EBP). This amendment applies to taxation years that end after December 21, 1992.

Subclause 39(4)

ITA
87(2)(j.6)

Paragraph 87(2)(j.6) of the Act provides that a corporation formed as the result of an amalgamation is considered, for the purposes of a number of provisions of the Act, to be the same corporation as, and a continuation of, each predecessor corporation. Paragraph 87(2)(j.6) is amended, effective after 1987, to include a reference to paragraph 20(1)(e.1) of the Act, which allows certain financing expenses that relate only to the year in which they are incurred to be deducted in that year. The amendment to paragraph 87(2)(j.6) also adds a reference to new section 20.1 of the Act, which provides rules that apply where borrowed money ceases to be used for an income-earning purposes because of a loss of source of income. New section 20.1 applies after 1993.

Clause 40

Winding-Up of a Corporation

ITA
88

Section 88 of the Act deals with the tax consequences arising from the winding-up of a corporation.

Subclause 40(1)

ITA
88(1)(d.2)

Paragraph 88(1)(d.2) of the Act applies in determining the time that a taxpayer last acquired control of a subsidiary for the purposes of the rules permitting a parent corporation to obtain, on the winding-up of a subsidiary, an increase in the adjusted cost base of certain capital properties owned by the subsidiary at the time that the parent last acquired control of the subsidiary. This paragraph applies where control of a subsidiary is acquired from a person or group of persons with whom the person or group of persons who acquired control does not deal at arm's length.

Paragraph 88(1)(d.2) provides that the acquisition of control of a subsidiary through a bequest or inheritance by a beneficiary from a non-arm's length person will be treated as having occurred at arm's length. This amendment, which applies to windings-up that begin after December 20, 1991, ensures that this treatment is also available where control of a subsidiary is acquired by a group of beneficiaries, rather than only where a single beneficiary is involved.

Subclause 40(2)

ITA
88(1)(e.3)(ii)(C)(I)

Paragraph 88(1)(e.3) of the Act provides for the flow-through of investment tax credits (ITCs) from a subsidiary corporation to a parent corporation on a winding-up of the subsidiary. Generally, clause 88(1)(e.3)(ii)(C) allows the parent corporation to reinstate ITCs that have been restricted as a result of a change of control of the subsidiary, to the extent that the parent has a tax liability under Part I of the Act in respect of income arising from the same business or a business similar to that in which the subsidiary earned the ITCs. The flow-through of ITCs on a change of control of a corporation is subject to the corporation satisfying the conditions contained in subparagraph 127(9.1)(d)(i) of the Act. Subsection 127(9.1) of the Act sets out the rules for determining the amount by which a corporation's carryforward of unused ITCs earned before a change in control is limited, under paragraph (j) of the definition "investment tax credit", for claims against taxes payable in respect of income earned after the change of control.

Subclause 88(1)(e.3)(ii)(C)(I) of the Act is amended to provide that the flow-through of otherwise restricted ITCs of a subsidiary to its parent corporation is conditional on the parent carrying on the business of the subsidiary throughout the year in which the flowed-through ITC is claimed. This change is intended to ensure that the treatment of ITCs of corporations experiencing a change of control is subject to the same limitations, regardless of whether the ITC claim is being made by the corporation or its parent (after winding-up the corporation).

This amendment applies to windings-up commencing after December 21, 1992.

Clause 41

Corporate Migration

ITA
88.1

In many jurisdictions, a company incorporated elsewhere may become naturalized by submitting itself to the corporate law of its new home. Such an action is often described as a corporate "continuance" or "continuation". Section 88.1 of the Act provides certain tax consequences where a corporation incorporated in Canada has been granted articles of continuance (or similar constitutional documents) outside Canada. As part of a set of amendments concerning taxpayers' residence and certain related matters, section 88.1 is to be repealed.

For a full description of the new rules in this area, readers should consult the relevant amendments and the accompanying explanatory notes. Briefly, new subsection 250(5.1) of the Act provides that after continuing into a jurisdiction, a corporation will be treated as having been incorporated there. As a result, a corporation that has been continued abroad will no longer be treated as a Canadian resident simply because it was incorporated here. Similarly, a corporation continued into Canada may become a "Canadian corporation" within the meaning of subsection 89(1) of the Act. In both cases, the migrating corporation will, to the extent that its place of incorporation affects its status as resident or non-resident, be subject to the rules in new section 128.1 of the Act regarding changes in residence.

Existing section 88.1 also applies where a corporation has, in effect, ceased to be resident here because of a tax treaty. In light of the interaction of subsection 250(5) of the Act and new section 128.1, section 88.1 is superfluous in these cases as well.

Section 88.1 is repealed after 1992, except where a corporation makes either of the elections provided for in subclause 111(4) with respect to new subsection 250(5.1) of the Act. Where a corporation elects under paragraph 111(4)(a) to have subsection 250(5.1) apply to a pre-1993 continuance, the repeal of section 88.1 will come into force as of that continuance. Where a corporation elects under paragraph 111(4)(b) not to be subject to subsection 250(5.1) in respect of a particular continuance before July 1994, the repeal will apply only after that continuance.

Clause 42

Definitions Relating to Corporations

ITA
89

Section 89 of the Act defines certain terms that apply in relation to corporations and their shareholders.

Subclause 42(1)

ITA
89(1)

"Canadian corporation"

Subsection 89(1) of the Act contains the definition of "Canadian corporation", a term which is relevant for many purposes under the Act. A corporation is a Canadian corporation at a given time if it is resident in Canada at that time and was either incorporated in Canada or has been resident here since June 18, 1971. This definition is amended to clarify the status of a corporation formed through an amalgamation, merger or other reorganization of two or more other corporations. As a result of this amendment, it will remain the case that such a reorganized corporation will be a Canadian corporation if it was resident in Canada since 1971; otherwise, the reorganized corporation will have that status only if two conditions are met. The corporation must have been formed under the laws of Canada or a province, and each of the corporation's predecessors must itself have been a Canadian corporation.

The amendment applies as of Royal Assent.

Subclause 42(2)

ITA
89(1)

"paid-up capital"

Subsection 89(1) of the Act contains the definition of "paid-up capital" in respect of a class of shares of the capital stock of a corporation. Subparagraph (b)(iii) of that definition provides that after March 31, 1977 paid-up capital is to be calculated without reference to the provisions of the Act other than those specified therein. This amendment to subparagraph (b)(iii) of the definition of "paid-up capital" adds references to new subsections 51(3), 86(2.1) and 128.1(2) and (3) of the Act and is consequential on the addition of those provisions. New subsections 51(3) and 86(2.1) ensure that, where shares of a class of the capital stock of a corporation in respect of which the paid-up capital for tax purposes is less than their stated capital are exchanged for shares of another class of the capital stock of the corporation and either of these subsections applies to the exchange, the paid-up capital deficiency will flow through to the class of shares received on the exchange. New subsections 128.1(2) and (3) of the Act apply in certain cases to adjust the paid-up capital of shares of a corporation which has become resident in Canada.

The addition of the references to new subsections 51(3) and 86(2.1) applies after August, 1992, while the addition of the reference to new subsections 128.1(2) and (3) applies after 1992.

Clause 43

Foreign Affiliates

ITA
95(2)(h)(i)

Paragraph 95(2)(h) of the Act provides that any foreign exchange gains or losses realized by a foreign affiliate of a taxpayer as a result of the redemption, cancellation or acquisition of a share of the capital stock of, or the reduction of the capital of, either that affiliate or any other foreign affiliate of the taxpayer shall, for the purposes of determining the affiliate's taxable capital gains or allowable capital losses, be deemed to be nil.

Subparagraph 95(2)(h)(i) of the Act is amended to clarify that a corporation that is a foreign affiliate of a taxpayer cannot realize a foreign exchange gain or loss on the redemption, cancellation or acquisition of a share of its own capital stock, or on the reduction of its own capital.

This amendment applies to redemptions, cancellations, acquisitions and reductions occurring after December 21, 1992.

Clause 44

Foreign Partnerships

ITA
96(8)

New subsection 96(8) of the Act applies where a partnership, none of the partners of which are Canadian residents, acquires a Canadian resident as a partner. This occurs when a Canadian resident becomes a member of such a partnership, or when a person who is a member of such a partnership becomes a resident of Canada. New subsection 96(8) contains a number of rules that apply in computing the income of the partnership for fiscal periods ending after the time at which the partnership acquires a Canadian resident partner.

New paragraph 96(8)(a) provides two rules that apply to depreciable property of a prescribed class (other than taxable Canadian property) held by such a partnership. First, subparagraph 96(8)(a)(i) provides that the undepreciated capital cost of the class of such property, held by the partnership at or before the time it acquires a Canadian resident partner, is adjusted to remove all amounts (other than amounts relating to previous recapture or depreciation deductions) associated with such property. Second, subparagraph 96(8)(a)(ii) provides that such property that is still held by the partnership at the time it acquires a Canadian resident partner is considered to have been acquired by the partnership, immediately before that time, at a capital cost equal to the lesser of the property's fair market value and capital cost.

This provision clarifies that capital cost allowance on the depreciable property of a partnership is to be based on capital costs that do not exceed the lesser of the fair market value of the partnership's property and its capital cost at the time when the property becomes relevant for purposes of the Canadian tax system.

New paragraph 96(8)(b) deals with inventory and non-depreciable capital property of such a partnership. It provides that the cost of inventory (other than inventory of a business carried on in Canada) and non-depreciable capital property (other than taxable Canadian property) of the partnership, immediately after the time at which it acquires a resident Canadian partner, is equal to the lesser of its fair market value and cost to the partnership.

This provision clarifies that a partnership that previously did not have a partner resident in Canada cannot import and allocate an unrealized loss to a Canadian partner.

New paragraph 96(8)(c) deals with dispositions of property. It provides that any loss on a disposition of property (other than inventory of a business carried on in Canada or taxable Canadian property) by the partnership before the time it acquires a Canadian resident partner is considered to be nil.

This clarifies that such a loss may not be allocated to Canadian partners, notwithstanding that the loss is incurred in the same fiscal period in which subsection 96(8) applies.

New paragraph 96(8)(d) deals with the cumulative eligible capital (CEC) of such a partnership. It provides that where 4/3 of the CEC of a business carried on outside Canada by the partnership at the time it acquires a Canadian partner is greater than the total of the fair market value of the related eligible capital property, the partnership is considered to have disposed of and received proceeds for an eligible capital property equal to the excess. This reduction in the CEC results in it being the lesser of the CEC otherwise determined and 3/4 of the total of the fair market value of each eligible capital property of the business.

In many respects these amendments are clarifying and, accordingly, the assessing practices of Revenue Canada applicable to partnership interests acquired before December 22, 1992 will continue to be applied by that department. Where circumstances warrant, Revenue Canada will consider the application of the general anti-avoidance rule in section 245 of the Act.

These amendments apply to a partnership of which a Canadian resident (including a partnership with a Canadian resident partner) becomes a member after December 21, 1992 or where a member of a partnership becomes resident in Canada after August 30, 1993, except that paragraph 96(8)(d) only applies after April 30, 1994.

ITA
96(9)

New subsection 96(9) of the Act provides that, where one of the main reasons that there is a member of the partnership who is resident in Canada is to avoid the application of subsection 96(8), that member of a partnership will not, for the purpose of applying subsection 96(8), be considered to be resident in Canada.

This amendment applies to a partnership where a person or partnership becomes a member of the partnership after December 21, 1992.

Clause 45

Disposition of Partnership Interest

ITA
98.1(1)(a)

Section 98.1 of the Act provides rules applicable to a taxpayer who ceases to be a member of a partnership but continues to have a residual interest in the partnership. Paragraph 98.1(1)(a) is amended to replace a reference to section 48 of the Act, which deems a disposition of certain property to occur where a taxpayer has ceased to be a resident of Canada, with a reference to new section 128.1 of the Act. New section 128.1 forms part of a set of amendments concerning taxpayers' residence and certain related matters.

This amendment generally applies after 1992, although it may also apply before that time to corporations electing to be subject to new subsection 250(5.1) of the Act. For further information, reference may be made to the commentary on that provision.

Clause 46

Trusts and Their Beneficiaries

ITA
104

Section 104 of the Act provides rules governing the tax treatment of trusts and their beneficiaries.

Subclause 46(1)

ITA
104(5)

Subsection 104(5) of the Act provides rules that treat depreciable property of most trusts as having been disposed of at its fair market value every 21 years. This deemed realization is meant to prevent trusts from being used to defer indefinitely the recognition of taxable gains with respect to trust property. The first deemed realization for pre-1972 trusts occurs on January 1, 1993.

Subsection 104(5) is amended to clarify the computation of the amount (known as the "undepreciated capital cost") that can be written-off by a trust subsequent to the deemed disposition in the event that the fair market value of depreciable property at the time of the deemed disposition is less than the original capital cost of the property. In these circumstances, this amendment ensures that the "undepreciated capital cost" of depreciable property after the reacquisition is equal to its "undepreciated capital cost" before the disposition plus any amount included in the trust's income by virtue of the disposition. The following example illustrates the effect of this amendment.

This amendment applies to deemed dispositions occurring after 1992.

EXAMPLE

A pre-1972 trust owns a building having an original capital cost of $100,000. The undepreciated capital cost of the building is $30,000, as a consequence of the trust having earlier claimed in total $70,000 as capital cost allowance (CCA). The fair market value of the building on January 1, 1993 is $80,000.

Result:

1. As a consequence of subsection 104(5), the trust includes in income "recaptured" CCA of $50,000 ($80,000 - $30,000).

2. The new undepreciated capital cost is equal to $80,000. This amount is determined as follows:

	(a)	$100,000	(original capital cost)
+	(b)	100,000	(capital cost on reacquisition)
+	(c)	50,000	(recaptured CCA)
-	(d)	70,000	(CCA previously claimed)
-	(e)	20,000	(CCA deemed to have been previously claimed)
-	(f)	80,000	(proceeds on deemed disposition)
		80,000	

3. In the absence of this change, it is arguable that the new undepreciated capital cost would have been computed without reference to items (a) and (d), above. This would clearly have been unintended.

Subclause 46(2)

ITA
104(22)

Subsection 104(22) of the Act enables a Canadian-resident trust to designate trust income included in a beneficiary's income as foreign income of the beneficiary, to the extent that the trust income is derived from foreign sources. As a consequence of the designation, a beneficiary of a trust is treated as having paid a pro-rata share of any foreign income tax paid by the trust and is intended to qualify for a foreign tax credit under section 126 of the Act. Where such a designation is made by a trust, any amount treated by virtue of the designation as foreign source income or foreign income tax of a beneficiary is treated as not being foreign source income or foreign income tax of the trust. The existing wording of subsection 104(22) does not distinguish between "business-income tax" and "non-business-income tax" paid by a trust. This is a technical deficiency as the rules in section 126 of the Act apply differently to the two different types of taxes.

Subsection 104(22) is amended by dividing the existing subsection into five new subsections. Former paragraphs 104(22)(a) to (d) correspond to new subsections 104(22) to (22.3). New subsection 104(22.4) defines "business-income tax" and "non-business-income tax" by reference to the definitions of those expressions in section 126.

The new subsections are structured so that a designation of foreign source income by a trust and the consequences of that designation are described on a source-by-source basis. This structure allows a distinction to be made between "business-income tax" and "non-business income tax" paid by a trust. New subsection 104(22.1) of the Act treats a beneficiary under a trust, as a consequence of the trust's designation under subsection 104(22), as having paid a pro-rata share of business-income tax or non-business-income tax paid by the trust. The pro-rata share for a beneficiary under a trust is equal to the proportion of the trust's income giving rise to such tax that was designated by the trust in favour of the beneficiary.

New subsections 104(22) and (22.1) also allow a trust to flow-out to its beneficiaries the portion of its business-income-tax paid to a foreign country in respect of a business carried on in another foreign country.

The new subsections also clarify the application of the flow-through rules where a beneficiary of a trust is another trust. In these circumstances, the lower-tier trust may designate foreign source income to the beneficiary trust, which itself may designate such amounts to its own beneficiaries. The new wording in subsection 104(22.2) clarifies that the beneficiary trust's foreign source income takes into account the foreign source income designated to it. New subsection 104(22.3), dealing with the recalculation of a trust's foreign tax, is amended in a similar manner.

These amendments apply to taxation years ending after November 12, 1981. Since subsection 104(22) applied in respect of trusts resident outside Canada for taxation years commencing before 1988, the amendments also apply with respect to those trusts for taxation years ending after November 12, 1981 and commencing before 1988.

Clause 47

Capital Interest in a Trust

ITA
107(1)(c)

Paragraph 107(1)(c) of the Act is a "stop-loss" rule which applies where a capital loss would otherwise be realized by a corporation on the disposition of the corporation's interest in a trust. The existing rule provides that the capital loss is reduced by dividends received by the trust before the disposition and flowed-through to the corporation under subsection 104(19) or (20) of the Act. The reason for this rule is that the capital loss from the disposition of an interest in a trust by a corporation is assumed to increase as a result of the payment of such dividends, without any corresponding increase in taxable income of the corporation because of the non-taxable treatment of capital dividends and the intercorporate dividend deduction for taxable dividends.

Paragraph 107(1)(c) is amended so that, where a trust is a "unit trust", dividends received by it before 1988 are disregarded for the purposes of this rule. This amendment is appropriate because, before 1988, losses with respect to the disposition of interests in units trust were not within the scope of paragraph 107(1)(c) because of the restrictive definition of "trust" in subsection 108(1).

Paragraph 107(1)(c) is also amended to ensure that a reduction in computing the taxpayer's capital loss from the disposition of a trust interest is not applied more than once. This amendment is relevant where a taxpayer makes partial dispositions of an interest in a trust at different times.

These amendments apply to the 1988 and subsequent taxation years.

Clause 48

Trusts – Definitions

ITA
108

Section 108 of the Act sets out certain definitions and rules that apply for the purposes of subdivision k of Division B of Part I of the Act, which deals with the computation of income of trusts and their beneficiaries.

Subclause 48(1)

ITA
108(1)

"eligible real property gain"
"eligible real property loss"
"eligible taxable capital gains"

Subsection 108(1) of the Act contains definitions of the terms "eligible real property gain", "eligible real property loss" and "eligible taxable capital gains" in respect of a trust. These terms are defined by reference to definitions in subsection 110.6(1) of the Act. The definitions in subsection 110.6(1) in turn refer to the term "non-qualifying real property", which is defined in both subsection 110.6(1) (in respect of the capital gains exemption rules for individuals) and subsection 108(1) (in respect of the rules for calculating capital gains of trusts eligible for the exemption in the hands of beneficiaries).

The definitions of "eligible real property gain", "eligible real property loss" and "eligible taxable capital gains" in subsection 108(1) are amended to clarify that the appropriate definition of "non-qualifying real property" for purposes of these definitions is that contained in subsection 108(1) of the Act. These amendments apply to the 1992 and subsequent taxation years.

Subclauses 48(2) and (3)

ITA
108(1)

"cost amount"

Subsection 108(1) of the Act contains a definition of "cost amount" to a taxpayer of a capital interest in a trust. Where the capital interest of a taxpayer in a trust is fully or partially satisfied on the distribution of property by the trust, the cost amount of the taxpayer's satisfied interest is the total of any cash and the cost amounts to the trust of other property so distributed. In any other case, the cost amount of the taxpayer's interest in a trust is determined by prorating the amount obtained by subtracting the trust's debts from the total of the trust's cash on hand and cost amounts of trust property. The proration factor for this purpose is the fair market value of the interest divided by the fair market value of all capital interests in the trust.

The definition of "cost amount " in subsection 108(1) of the Act is amended in three respects. First, paragraph (a) of the definition is amended to remove the exclusion of eligible capital property in respect of a business from the application of that paragraph. Second, subparagraph (ii) of paragraph (a) of the definition is repealed. Third, the description of "A" in paragraph (b) of the definition is amended to remove the exclusion of eligible capital property in respect of a business from the application of subparagraph (ii) of that description and to repeal subparagraph (iii). These amendments, like the amendment to paragraph 85(4)(b) of the Act described in these notes, are consequential on a previously-enacted amendment to the definition of "cost amount" in subsection 248(1) of the Act, so that the 4/3 gross-up of cumulative eligible capital is now provided under subsection 248(1).

These amendments apply after July 13, 1990.

Subclause 48(4)

ITA
108(1)

"testamentary trust"

Subsection 108(1) of the Act contains a definition of "testamentary trust" as a trust or estate that arose on and in consequence of the death of an individual (including a trust referred to in subsection 70(6.1) of the Act), and provides some exceptions to that definition. Prior to its repeal and replacement by subsection 248(9.1) of the Act, subsection 70(6.1) referred to trusts created under the terms of a taxpayer's will and trusts created by an order of a court in relation to the taxpayer's estate pursuant to dependants' relief legislation. This consequential amendment to the definition of "testamentary trust", which applies to the 1990 and subsequent taxation years, replaces a reference to subsection 70(6.1) with a reference to subsection 248(9.1).

Clause 49

Deductions in Computing Taxable Income

ITA
110

Section 110 of the Act provides various deductions that may be claimed in computing a taxpayer's taxable income for a year.

Subclause 49(1)

ITA
110(1)(d)(iii)

Paragraph 110(1)(d) of the Act provides a special deduction in computing an employee's income in respect of certain stock option benefits. This deduction is equal to one-quarter of the amount of the benefit included in an employee's income under subsection 7(1) of the Act.

Subparagraph 110(1)(d)(iii) of the Act requires that, in order to qualify for the deduction, the option price in respect of the shares must not be less than the excess of the fair market value of the share at the time the option was acquired over the cost of the option to the employee.

Subparagraph 110(1)(d)(iii) is amended, effective for the 1992 and subsequent taxation years, to eliminate the effect of foreign exchange gains and losses when determining eligibility for the deduction.

Subclause 49(2)

ITA
110(1)(f)(ii)

Paragraph 110(1)(f) of the Act allows certain items of income to be deducted in computing a taxpayer's taxable income. Subparagraph 110(1)(f)(ii) allows the deduction of certain compensation amounts received under an employers' or workers' compensation law for injury, disability or death. This amendment merely clarifies the date on which a previous amendment to subparagraph 110((1)(f)(ii) came into force.

Subclause 49(3)

ITA
110(1)(f)(iv)

New subparagraph 110(1)(f)(iv) of the Act permits a taxpayer who is not a Canadian citizen at any time in a taxation year a deduction from taxable income equal to the amount included in the taxpayer's income for the year in respect of employment with a "prescribed international non-governmental organization". To qualify for the deduction, the taxpayer must have been a non-resident person immediately before beginning employment in Canada with the organization, and, if the taxpayer is resident in Canada, must have become resident solely for the purpose of that employment. It is intended that the International Air Transport Association and the Société internationale de télécommunications aéronautiques be prescribed for this purpose, applicable to the 1993 and subsequent taxation years.

Clause 50

Capital Gains Exemption

ITA
110.6

Section 110.6 of the Act sets out the rules for calculating an individual's entitlement to the lifetime capital gains exemption.

Subclause 50(1)

ITA
110.6(1)

"annual gains limit"
"cumulative gains limit"

The definitions of "annual gains limit" and "cumulative gains limit" were amended by Chapter 24 of the *Statutes of Canada*, 1993 (Bill C-92), effective for the 1988 and subsequent taxation years, to provide that the annual gains limit and the cumulative gains limit of an individual were to be reduced by net capital losses of one year carried over and deducted in another year only to the extent that such losses were deducted against gains eligible for inclusion in the annual gains limit and the cumulative gains limit of the individual. This amendment extends this relief to the 1985 and subsequent taxation years.

Subclauses 50(2), (3) and (4)

ITA
110.6(1)

"non-qualifying real property"

Capital gains realized on the disposition of non-qualifying real property may not be eligible for the capital gains exemption. "Non-qualifying real property" of an individual means (with a number of exceptions) real property, or a share of the capital stock of a corporation or interest in a partnership or trust the fair market value of which is derived principally from real property, disposed of after

February 1992 by the individual, or by a partnership of which the individual is a member. Also included in the definition are interests or options in respect of such real property, shares or interests.

Paragraph (b) of the definition of "non-qualifying real property" in subsection 110.6(1) of the Act is amended, applicable to the 1992 and subsequent taxation years, to provide that a share of the capital stock of a corporation will not constitute non-qualifying real property of an individual where the value of the share is derived principally from real property owned by another corporation, a partnership or a trust (or any combination thereof), the shares of the capital stock of which would, or in the case of a partnership or trust, the interests in which would, if they were owned by the individual, not constitute non-qualifying real property of the individual. Similar amendments are made to paragraphs (c) and (d) of the definition, which deal with partnership interests and beneficial interests in trusts respectively. These amendments are intended to allow the exclusion for real property that is used principally in an active business to apply whether the property is owned and used by the top-tier corporation, partnership or trust or by a lower-tier corporation, partnership or trust.

Subclause 50(5)

ITA
110.6(15)

In order for a share of the capital stock of a corporation to qualify as a share of the capital stock of a "small business corporation", a "qualified small business corporation share" or a "share of the capital stock of a family farm corporation", a number of tests relating to the fair market value of the assets of the corporation must be met. In particular, a certain percentage of the fair market value of the corporation's assets must be attributable either to assets used principally in certain activities, or to shares or indebtedness of a connected corporation (within the meaning assigned by subsection 186(4) of the Act), the shares of which would themselves qualify for the purposes of those definitions.

Subsection 110.6(15) of the Act provides rules for valuing certain assets for the purposes of the definitions "qualified small business corporation share" and "share of the capital stock of a family farm corporation" in section 110.6 and the definition "small business corporation" in subsection 248(1) of the Act. Subsection 110.6(15) is amended in two respects. The first amendment makes the subsection apply for the purposes of the definition "share of the capital stock of a family farm corporation" in subsection 70(10) of the Act. The second amendment adds new paragraph 110.6(15)(b) which is intended to eliminate circularity when determining whether or not shares of a corporation that owns shares or indebtedness of a connected corporation qualify as one of the special types of shares described above.

For example, where a corporation (Subco) owns shares or indebtedness of a corporation (Parentco) with which it is connected there is a potential for circularity in the existing rules relating to the determination of whether or not the shares of Parentco qualify as qualified small business corporation shares for the purposes of the enhanced capital gains exemption. New paragraph 110.6(15)(b) deals with this circularity by providing that, for the purposes of applying the definition "qualified small business corporation share" in respect of a determination involving the shares of Parentco, the fair market value of any shares or indebtedness of Parentco, owned by Subco, is nil. The new paragraph, which applies to dispositions occurring after 1991, will, however, not apply where Parentco is connected with Subco (within the meaning of subsection 186(4) of the Act determined without reference to subsection 186(2)).

Clause 51

Taxable Dividends Received by Corporations

ITA
112

Section 112 of the Act is one of the principal provisions of the Act dealing with the treatment of dividends received by a corporation.

Subclause 51(1)

ITA
112(2.6)

"exempt share"

Subsection 112(2.6) of the Act defines several terms, including "exempt share", for the purposes of subsection 112(2.4). The latter provision may operate to deny the intercorporate dividend deduction provided under subsection 112(1) or (2) for dividends received on shares generally referred to as collateralized preferred shares. Exempt shares are excluded from the operation of subsection 112(2.4).

The definition "exempt share" is amended, applicable after December 21, 1992, to include a share described in paragraph (e) of the definition "term preferred share" in subsection 248(1) of the Act (commonly referred to as a "distress preferred" or "financial difficulty" share). This amendment ensures that the collateralized preferred share provisions will not operate to deny the intercorporate dividend deduction for dividends received on such shares.

Subclauses 51(2), (3) and (4)

ITA
112(4)(d)(ii), (4.1)(d)(ii) and (4.2)(d)(ii)

Subsection 112(4) of the Act provides that the amount that a taxpayer may claim in respect of a loss arising on a share held as inventory is reduced by certain dividends received by the taxpayer on the share, unless the taxpayer satisfies the conditions set out in paragraphs 112(4)(a) and (b). Subsection 112(4.2) of the Act provides a similar rule for a taxpayer who is a member of a partnership that holds inventory shares. Similarly, subsection 112(4.1) of the Act may operate to increase, for the purposes of inventory valuation, the fair market value of an inventory share on which dividends have been received.

Paragraphs 112(4)(d), (4.1)(d) and (4.2)(d) of the Act apply to corporate taxpayers. Each of these provisions is amended to exclude from the operation of the stop-loss or inventory valuation rule capital gains dividends received by a corporation. Capital gains dividends are, by reason of paragraph 112(6)(a), not deductible under subsection 112(1) in computing the taxable income of the corporate taxpayer.

The amendments to subparagraphs 112(4)(d)(ii) and (4.2)(d)(ii) apply to the determination of losses arising in the 1990 and subsequent taxation years, restoring the treatment in this regard of capital gains dividends received by a corporation to that which existed prior to the enactment of Bill C-18 (S.C. 1991, c. 49, s. 84). Since subsection 84(6) of that statute provided that a taxpayer could elect to have the relevant changes apply to the 1985 to 1989 taxation years, these amendments also apply to losses arising in the 1985 to 1989 taxation years if the taxpayer had so elected. Similarly, the amendment to subparagraph 112(4.1)(d)(ii) applies to the 1990 and subsequent taxation years and to the 1985 to 1989 taxation years where the taxpayer has made an election under subsection 84(7) of Chapter 49 of the *Statutes of Canada.*

Subclause 51(5)

ITA
112(7)

Subsection 112(7) of the Act provides special rules relating to the application of the "stop-loss" rules in subsections 112(3), (3.1) and (3.2) of the Act to shares that have been exchanged in certain corporate reorganizations. For the purpose of determining the amount by which a loss on a disposition of a "new" share is to be reduced (over and above any reduction attributable to dividends paid on the new share), subsection 112(7) provides, in general terms, that taxable dividends, capital dividends and life insurance capital dividends received or designated on all the "old" shares exchanged by the holder are to be allocated to the new shares issued on the exchange in proportion to the adjusted cost bases to the holder of the new shares immediately after the exchange.

Paragraph 112(7)(b) of the Act is amended, applicable to losses arising in the 1992 and subsequent taxation years, to limit the amount of the dividends received or credited on an old share that can be applied to reduce a loss realized on the disposition of a new share to the lesser of: the taxable dividends, capital dividends and life insurance capital dividends received or designated on the old share;

and the adjusted cost base to the holder of the old share immediately before the time of the exchange. The amount that "survives" the reorganization for these purposes will continue to be allocated to the new shares in proportion to their adjusted cost bases to the holder immediately after the exchange.

Clause 52

Part-Year Residents

ITA
114

Section 114 of the Act provides rules for computing the taxable income of an individual who was resident in Canada during part of a taxation year. The section is amended to apply to individuals who, while non-residents of Canada for part of a year, were employed or carrying on business here at that time. The amendment ensures that an individual who becomes or ceases to be a resident in a year is taxable, while a non-resident, only on Canadian-source income.

This amendment applies to the 1992 and subsequent taxation years, except that a taxpayer may elect not to have this amendment apply to the taxpayer's 1992 year by notifying the Minister of National Revenue in writing within 6 months after the month in which Royal Assent to this amendment is received.

Clause 53

Disability Tax Credit Transfer

ITA
118.3(2)

Subsection 118.3(2) of the Act provides criteria for determining the entitlement of a supporting individual of a disabled person to claim that person's unused disability tax credit. A parent is allowed to claim the unused portion of a child's disability tax credit for a year for which the parent has claimed a dependant tax credit or an equivalent-to-married credit in respect of the child (or could have done so had the parent been unmarried and the child had no income for the year). As a result of the introduction of the child tax benefit which replaces, among other provisions, the dependant tax credit for dependants under 18 years of age and the fact that a supporting individual cannot claim more than one equivalent-to-married credit for a year, subsection 118.3(2) is amended to ensure that, where a parent supports two or more disabled children, the parent will be entitled to benefit from the transfer of the unused portion of the disability tax credit of those children. This amendment applies beginning in 1993.

Clause 54

Tuition Fees

ITA
118.5(1)

Subsection 118.5(1) of the Act provides a tax credit for tuition fees paid to certain educational institutions. The French version of clause 118.5(1)(a)(ii.2)(A) is amended, effective for the 1992 and subsequent taxation years, to ensure that the English and French versions correspond in meaning.

Clause 55

Tax Credits – Part-Year Residents

ITA
118.91

Section 118.91 of the Act provides rules with respect to non-refundable tax credits allowed to individuals residing in Canada for only part of a taxation year. In keeping with the amendment to section 114 of the Act, this amendment to section 118.91 modifies the treatment of periods during which a part-year resident was not resident but was carrying on business in Canada or was employed here. In such circumstances, an individual's eligibility for the various credits listed in paragraph 118.91(b) will be determined without reference to such periods.

This amendment applies to the 1992 and subsequent taxation years, except that where a taxpayer elects not to have section 114, as amended, apply to the taxpayer's 1992 taxation year, then the provisions of amended section 118.91 will also not apply to that taxpayer for that year.

The effect of these amendments may be seen in the following example. N., an individual, becomes a Canadian resident on July 1, 1993. Between January 1 and June 30, 1993, while a non-resident, N. was employed in Canada. Under the existing rules in sections 114 and 118.91 of the Act (assuming no treaty provision applies), N. will be subject to Canadian tax on worldwide income for the entire year, and will be entitled to claim tax credits applicable to the same period. As a result of these amendments, N. will be taxed on worldwide income only for that part of the year N. was resident in Canada, and will be entitled to tax credits only in respect of the same period.

Clause 56

Overseas Employment Tax Credit

ITA
122.3

Section 122.3 of the Act provides an "overseas employment tax credit" to individuals resident in Canada who are employed outside Canada by a specified employer for at least six months in connection with resource, construction, installation, agricultural or engineering contracts or for the purposes of obtaining those contracts.

The overseas employment tax credit is determined by multiplying an employee's Part I tax otherwise payable for a taxation year by a fraction: the numerator of that fraction, determined under paragraphs 122.3(1)(c) and (d), consists of the lesser of $80,000 and 80% of the individual's overseas employment income for the year; the denominator of that fraction, determined under paragraph 122.3(1)(e), is the individual's income for the year (or, where section 114 of the Act applies, for the period or periods in the year referred to in paragraph 114(a)) reduced by certain deductions listed in subparagraph 122.3(1)(e)(iii). The $80,000 figure set out in paragraph 122.3(1)(c) is reduced, on a prorated basis, if the number of days in the "qualifying period" or on which the individual was resident in Canada or carried on business in Canada that are in the year is less than 365.

The amendment to subparagraph 122.3(1)(c)(ii) is consequential on amendments to section 114 of the Act that ensure that an individual who becomes, or ceases to be, resident in Canada in a year is no longer subject to tax on non-Canadian source income earned while a non-resident but during a part of the year in which the individual carries on business in Canada. Amended subparagraph 122.3(1)(c)(ii) applies to the 1992 and subsequent taxation years, but does not apply to the 1992 taxation year of an individual who has elected not to have amended section 114 apply to that year.

Subparagraph 122.3(1)(e)(ii), which applies in determining the denominator of the fraction described above where an individual is resident in Canada during only part of the taxation year in question, ensures that in prorating Part I tax otherwise payable to determine the appropriate credit, all amounts in respect of which that tax is generated are taken into account. Specifically, the amendment to this subparagraph includes in the denominator of the ratio not only the individual's income for the period in the year during which the individual was resident in Canada but also the individual's "taxable income earned in Canada" (subject to certain adjustments) as determined under section 115 of the Act for the period in the year during which the individual was not resident in Canada. The adjustments to the individual's taxable income earned in Canada used in the denominator of the ratio ensure that the overseas employment tax credit is determined on the basis of income before the deductions listed in paragraphs 115(d) to (f) are taken into account.

Amended subparagraph 122.3(1)(e)(ii) applies to the 1993 and subsequent taxation years.

Clause 57

Goods and Services Tax Credit

Section 122.5 of the Act provides the rules for determining the goods and services tax (GST) credit for individuals.

Subclause 57(1)

ITA
122.5(3)

Under subsection 122.5(3) of the Act, to receive a GST credit for a taxation year, an eligible individual must complete a "prescribed form" that must be filed with the individual's income tax return for the year. This amendment, which applies beginning with the 1992 income tax return, removes the requirement that a form be filed for the GST credit with the individual's return. An individual may now apply for the credit on the income tax return itself.

Subclause 57(2)

ITA
122.5(5)(a)

Paragraph 122.5(5)(a) of the Act provides that, where an individual is a qualified relation of another individual, only one individual may claim the GST credit. This amendment, which applies beginning with the 1992 income tax return and is consequential on the amendment to subsection 122.5(3) of the Act, removes the requirement that a form be filed for the GST credit.

Subclause 57(3)

ITA
122.5(6)

Subsection 122.5(6) of the Act enables the surviving spouse of a deceased individual to file an application in "prescribed form" to receive the remaining GST credit payments that would otherwise have been made to the individual. This amendment, which applies to payments determined on the basis of an income tax return filed for 1992 or a subsequent year, removes the requirement that such an application be made in prescribed form. As well, this amendment further extends the period during which the application may be made from 60 days after the date of the individual's death to the due date of the individual's tax return for the year of death. As in the past, applications made after the deadline may be accepted under certain circumstances.

Clause 58

Deduction of Part VI Tax

ITA
125.2(3)

Part VI of the Act levies a tax on capital employed in Canada by large financial institutions. Section 125.2 provides that, for taxation years ending before 1992 (generally), this Part VI tax may be deducted against the institution's tax payable under Part I; Part VI tax in excess of Part I tax for a given year creates an "unused Part VI tax credit" that may be deducted against Part I tax arising in any of the three preceding or seven following years.

Subsection 125.2(3) of the Act defines the term "unused Part VI tax credit" for the purposes of determining the amount of Part VI tax that may be deducted against Part I tax payable. The amendments to subsection 125.2(3) are consequential on the introduction of an additional tax payable by life insurance corporations under subsection 190.1(1.1) of Part VI of the Act, and ensure that this additional Part VI tax liability cannot be carried back to reduce Part I tax for taxation years to which the additional tax does not apply.

Amended subsection 125.2(3) generally applies in computing a corporation's "unused Part VI tax credit" for the 1992 and subsequent taxation years.

Clause 59

Deduction of Part I.3 Tax

ITA
125.3(4)

"Canadian surtax payable"

Subsection 125.3(4) of the Act contains a definition of the term "Canadian surtax payable". This definition is relevant in determining the amount of tax payable under Part I.3 of the Act (Large

Corporations Tax) that is deductible from a corporation's Part I tax and in determining the amount of Part I tax deductible in computing Part I.3 tax. Subsection 125.3(4) is amended to clarify that a corporation's Canadian surtax payable for a particular year may not exceed its Part I tax liability, after the deduction of all relevant tax credits, for that year. This amendment applies to the 1994 and subsequent taxation years.

Clause 60

Foreign Tax Credit

ITA
126

Section 126 of the Act permits a taxpayer to claim a foreign tax credit.

Subclause 60(1)

ITA
126(1)(b)

Subsection 126(1) of the Act sets out the rules for claiming a tax credit in respect of foreign non-business income tax – that is, foreign taxes levied on investment and other non-business income. The credit is determined by multiplying the taxpayer's Part I tax otherwise payable for a taxation year by a fraction: the numerator of that fraction, determined under subparagraph 126(1)(b)(i), consists of the taxpayer's income for the year (or, where section 114 of the Act applies, for the period or periods in the year referred to in paragraph 114(a)) from sources in the particular country calculated on certain assumptions; and the denominator of that fraction, determined under subparagraph 126(1)(b)(ii), consists generally of the amount by which the taxpayer's income for the year (or, where section 114 of the Act applies, for the period or periods in the year referred to in paragraph 114(a)) exceeds the deductions listed in subclause 126(1)(b)(ii)(A)(III). Also included in the denominator are any amounts added to a corporate taxpayer's taxable income under section 110.5 of the Act to avoid wastage of the foreign tax credit. The foreign tax credit claimed under subsection 126(1) may not exceed the non-business-income tax paid by the taxpayer to the particular country.

Subclause 126(1)(b)(ii)(A)(II), which applies in determining the denominator of the fraction described above where an individual is resident in Canada during only part of the taxation year in question, ensures that in prorating Part I tax otherwise payable to determine the appropriate credit, all amounts in respect of which that tax is generated are taken into account. Specifically, the amendment to this subclause includes in the denominator not only the individual's income for the period in the year during which the individual was resident in Canada but also the individual's "taxable income earned in Canada" (subject to certain adjustments) as determined under section 115 of the Act for the period in the year during which the individual was not resident in Canada. The adjustments to the individual's taxable income earned in Canada used in the denominator ensure that this credit is determined on the basis of income before the deductions listed in paragraphs 115(d) to (f) are taken into account.

Amended subclause 126(1)(b)(ii)(A)(II) applies to the 1993 and subsequent taxation years.

Subclauses 60(2) and (3)

ITA
126(2.1)

Subsection 126(2.1) of the Act sets out rules for determining the amount that may be deducted by a taxpayer under subsection 126(2) in respect of businesses carried on by the taxpayer in a country other than Canada. This amount may not exceed the total of the business-income tax paid by the taxpayer in that country in the year and the taxpayer's unused foreign tax credits carried forward or back to the year.

The amount determined under paragraph 126(2.1)(a) is computed by multiplying the taxpayer's Part I tax otherwise payable for a taxation year by a fraction: the numerator of that fraction, determined under subparagraph 126(2.1)(a)(i), consists of the taxpayer's income for the year (or, where section 114 of the Act applies, for the period or periods in the year referred to in paragraph 114(a)) from businesses carried on by the taxpayer in the particular country. Excluded from the numerator are amounts exempted from income tax because of a tax treaty. The denominator of this fraction, determined under subparagraph 126(2.1)(b)(ii), consists generally of the amount by which the taxpayer's income for the year (or, where section 114 of the Act applies, for the period or periods in the year referred to in paragraph 114(a)) exceeds the deductions listed in subclause 126(2.1)(a)(ii)(A)(III). Also included in the denominator are any amounts added to a corporate taxpayer's taxable income under section 110.5 of the Act to avoid wastage of the foreign tax credit.

Subclause 126(2.1)(a)(ii)(A)(II), which applies in determining the denominator of the fraction described above where an individual is resident in Canada during only part of the taxation year in question, ensures that in prorating Part I tax otherwise payable to determine the appropriate credit, all amounts in respect of which that tax is generated are taken into account. Specifically, the amendment to this subclause includes in the denominator not only the individual's income for the period in the year during which the individual was resident in Canada but also the individual's "taxable income earned in Canada" (subject to certain adjustments) as determined under section 115 of the Act for the period in the year during which the individual was not resident in Canada. The adjustments to the individual's taxable income earned in Canada used in the denominator ensure that the amount determined under this subsection is computed on the basis of income before the deductions listed in paragraphs 115(d) to (f) are taken into account.

Paragraph 126(2.1)(b) of the Act, which applies to potentially increase the amount of the foreign tax credit that may be deducted under subsection 126(2) where the taxpayer has income for the year not earned in a province, operates in a manner similar to paragraph 126(2.1)(a) except that the amount determined is based on the additional tax payable by the taxpayer because of subsection 120(1) of the Act. The amendment to clause 126(2.1)(b)(ii)(B) is identical to the amendment described above.

The amendments to subsection 126(2.1) apply to the 1993 and subsequent taxation years.

Subclause 60(4)

ITA
126(2.2)

Subsection 126(2.2) of the Act provides a special rule for determining the foreign tax credit of a taxpayer who disposes of property treated by subsection 48(2) of the Act as taxable Canadian property of the taxpayer — that is, property in respect of which the taxpayer chose to defer a deemed disposition on ceasing to be resident in Canada. Subsection 126(2.2) is amended to replace the reference to subsection 48(2) with a reference to new paragraph 128.1(4)(e) of the Act. Paragraph 128.1(4)(e), which forms part of a set of amendments concerning taxpayers' residence and certain related matters, is generally analogous to, and replaces, subsection 48(2).

This amendment generally applies after 1992, although it may also apply before that time to corporations electing to be subject to new subsection 250(5.1) of the Act. For further information, reference may be made to the commentary on that provision.

Subclause 60(5)

ITA
126(3)(b)

Subsection 126(3) of the Act provides a tax credit to employees of international governmental organizations other than prescribed international governmental organizations. The amount of the credit is limited to the amount of any levy in lieu of taxes charged to the employee by the organization on the employee's remuneration.

The credit that may be claimed under subsection 126(3) is determined by multiplying the employee's Part I tax otherwise payable for a taxation year by a fraction: the numerator of that fraction, determined under paragraph 126(3)(a), consists of the employee's income for the year (or, where section 114 of the Act applies, for the period or periods in the year referred to in paragraph 114(a)) from employment with the organization; and the denominator of the fraction, determined under paragraph 126(3)(b), consists generally of the amount by which the employee's income for the year (or, where section 114 of the Act applies, for the period or periods in the year referred to in paragraph 114(a)) exceeds the deductions listed in subparagraph 126(3)(b)(iii).

Subparagraph 126(3)(b)(ii), which applies in determining the denominator of the fraction described above where the employee is resident in Canada during only part of the taxation year in question, ensures that in prorating Part I tax otherwise payable to determine the appropriate credit, all amounts in respect of which that tax is generated are taken into account. Specifically, the amendment to this subparagraph includes in the denominator not only the employee's income for the period in the year during which the employee was resident in Canada but also the employee's "taxable income earned in Canada" (subject to certain adjustments) as determined under section 115 of the Act for the period in the year during which the employee was not resident in Canada. The adjustments to the employee's taxable income earned in Canada used in the denominator ensure that this credit is determined on the basis of income before the deductions listed in paragraphs 115(d) to (f) are taken into account.

Amended paragraph 126(3)(b) applies to the 1993 and subsequent taxation years.

Subclause 60(6)

ITA
126(7)

"non-business-income tax"

Subsection 126(7) of the Act contains a definition of the term "non-business-income tax" paid by a taxpayer for a taxation year for the purposes of determining the taxpayer's foreign tax credit. It is defined, subject to a number of exceptions, as income or profits tax paid by a taxpayer to a foreign government. One of the exceptions is that tax included in a taxpayer's business-income tax is not included in the taxpayer's non-business-income tax.

The definition of "non-business-income tax" is amended to also except from non-business-income tax an amount that is in respect of an amount deducted under subsection 104(22.3) of the Act in computing the taxpayer's business-income tax. This amendment is relevant where a trust pays an amount that, apart from the rule in new subsection 104(22.3), would have been its business-income tax. If the trust designates foreign source income to beneficiaries and, as a consequence, reduces its business-income tax under new subsection 104(22.3), the trust cannot rely on the definition of "business-income tax" to re-characterize the amount as its non-business-income tax.

This amendment applies to taxation years ending after November 12, 1981.

Clause 61

Investment Tax Credits

ITA
127

Section 127 of the Act permits deductions in computing tax payable in respect of logging taxes, political contributions and investment tax credits. Subsection 127(9) provides the definitions that apply to investment tax credits.

Subclause 61(1)

ITA
127(9)

"qualified expenditure"

The definition "qualified expenditure" in subsection 127(9) of the Act describes the type of expenditures that are eligible to earn investment tax credits. Expenditures included in the scientific research and experimental development ("SR&ED") pool under paragraph 37(1)(a) and subparagraph 37(1)(b)(i), other than prescribed expenditures, are generally eligible to earn investment tax credits. The rate at which the credits are earned may be 20%, 30% or 35%, depending on the year in which the expenditures are incurred, where in Canada they are incurred and whether the taxpayer is an individual, public corporation or Canadian-controlled private corporation.

The definition "qualified expenditure" is amended by adding new paragraph (c). New paragraph (c) generally excludes from SR&ED expenditures eligible for an investment tax credit expenditures in respect of which the taxpayer does not file a prescribed form with the Minister of National Revenue by the taxpayer's tax return filing due date for the taxation year following the year in which the expenditures are incurred. This amendment applies after February 21, 1994 to expenditures incurred at any time. For SR&ED expenditures incurred in taxation years ending before February 22, 1994, a taxpayer may file the prescribed form by the later of the day provided for in new paragraph (c) and 90 days after new paragraph (c) receives Royal Assent.

Subclauses 61(2) and (3)

ITA
127(9)

"qualified property"

The definition "qualified property" in subsection 127(9) of the Act, which applies for the purposes of investment tax credits (ITCs), includes certain prescribed buildings, machinery and equipment that is used primarily for activities that are described therein. That definition is amended in two respects.

First, new paragraph (c.1) is added to extend the definition "qualified property" to property used in Canada primarily for the purpose of producing or processing electrical energy or steam in a prescribed area. This treatment is conditional on certain conditions being satisfied in respect of the energy or steam. In particular, all or substantially all of the energy or steam is to be: a) used by the taxpayer for the purpose of producing income from a business (other than the business of selling the product of the particular property), or b) sold directly (or indirectly by way of sale to a provincially regulated power utility operating in the prescribed area) to a related person. Further, the energy or steam is to be used by the taxpayer or a person related to the taxpayer primarily for the purpose of manufacturing or processing goods in the prescribed area for sale or lease. The areas that are to be prescribed are the provinces of Newfoundland, Nova Scotia, New Brunswick and Prince Edward

Island and the Gaspé Peninsula. This amendment applies to property acquired after 1991.

Second, paragraph (d) of the definition "qualified property" describes certain property that is leased by a taxpayer to a lessee who can reasonably be expected to use the property in Canada primarily for any of the purposes referred to in subparagraphs (c)(i) to (xiii) (e.g., fishing). However, this treatment does not apply to leased property of the taxpayer unless, among other things, the property is leased in the ordinary course of carrying on a business in Canada by a corporation whose principal business is the leasing of property.

Paragraph (d) of the definition "qualified property" is amended to add new subparagraph (iv). Subparagraph (iv) extends eligibility of leased property for ITC treatment to property that is a fishing vessel, (including its furniture, fittings and equipment) leased by an individual (other than a trust) to a corporation controlled by the individual that carries on a fishing business in connection with one or more commercial fishing licenses issued by the Government of Canada to the individual. This amendment ensures that those fishermen who are required by government fishing policy to hold their licenses and vessels personally, but for commercial reasons carry on their fishing activities through a controlled corporation, may qualify for ITCs in respect of their fishing vessels. This amendment applies to the 1980 and subsequent taxation years.

Subclause 61(4)

ITA

127(11.4)

New subsection 127(11.4) of the Act, which is effective after February 21, 1994, provides that, for the purpose of the definition "qualified expenditure" in subsection 127(9), where, on the assessment of a taxpayer's return of income for a taxation year, or on a determination that no tax is payable for that year, a cost or expense incurred by the taxpayer in the year is reclassified by the Minister of National Revenue as an SR&ED expenditure in the course of an audit initiated by Revenue Canada, paragraph (c) of that definition does not apply in respect of that expenditure. In these circumstances, a taxpayer will not be prohibited from treating the SR&ED expenditure as a qualified expenditure solely because the taxpayer did not file the prescribed form in respect of the expenditure. The Minister of National Revenue will not reclassify an expenditure as a result of a taxpayer requested adjustment.

Clause 62

Changes in Residence

ITA
128.1 and 128.2

New section 128.1 of the Act sets out the income tax effects of becoming or ceasing to be resident in Canada. For the most part, section 128.1 simply consolidates and clarifies the rules in existing sections 48 and 88.1 of the Act, both of which are to be repealed with the enactment of the new section. There are, nonetheless, some respects in which section 128.1 differs from its predecessors. Both the new features of section 128.1 and its correspondence to the existing provisions are described in the detailed commentary below.

New section 128.2 of the Act ensures that appropriate tax results obtain where two or more corporations residing in different countries are merged or otherwise reorganized to form a single corporation.

Sections 128.1 and 128.2 apply after 1992, although they may also apply before that time to corporations electing to be subject to new subsection 250(5.1) of the Act. For further information, reference may be made to the commentary on that provision.

Immigration

ITA 128.1(1)

New subsection 128.1(1) of the Act provides rules that apply when a taxpayer becomes resident in Canada. The time at which residence is adopted is referred to in subsection 128.1(1) as "the particular time", and the events deemed under this subsection to take place on the acquisition of residence are timed by reference to that moment.

The first event triggered by a taxpayer's immigration is the deemed year-end described in paragraph 128.1(1)(a). The taxation year of an immigrating corporation or trust is deemed to have ended immediately before the taxpayer becomes resident in Canada, and a new year is deemed to have commenced at the particular time. Starting with that new year, the immigrating corporation or trust may select a new fiscal period. No year-end is provided for individuals other than trusts.

Second, paragraph 128.1(1)(b) treats the taxpayer as having disposed of each property owned by the taxpayer, other than certain specified properties, for proceeds equal to the property's fair market value. This disposition is deemed to have taken place immediately before the time immediately before the particular time. Corporations and trusts, whose taxation year is deemed under paragraph 128.1(1)(a) to have ended, will therefore realize any gain or loss in a year during which they were non-resident. It should be noted that subsection 128.1(1) applies for the purposes of the Act; as a result, this deemed disposition and the accompanying deemed reacquisition may later affect the valuation of the immigrating taxpayer's property for capital cost allowance and inventory purposes, as well as for purposes of computing any capital gain or loss.

The properties exempt from a deemed disposition on immigration under paragraph 128.1(1)(b) are essentially those properties which were, ignoring any relevant tax treaty, already subject to tax in this country. In this category are taxable Canadian property, Canadian business inventory, and eligible capital property in respect of a Canadian business. Employee stock options that are subject to section 7 of the Act are also exempt from a deemed disposition. In addition, a taxpayer who elected on an earlier emigration not to be deemed to have disposed of a given property will not be deemed to have disposed of that property on moving back to Canada.

Third, paragraph 128.1(1)(d) provides that where the immigrating taxpayer was a foreign affiliate of a taxpayer resident in Canada, that affiliate is deemed to have been a controlled foreign affiliate of that other taxpayer immediately before the particular time, and a prescribed amount is included in the affiliate's foreign accrual property income for the year deemed to have ended at that time. This provision is comparable to the existing subsection 48(5) of the Act, and it is intended that consequential changes be made to subsection 5907(13) of the *Income Tax Regulations* to reflect the replacement of subsection 48(5) with paragraph 128.1(1)(d).

Finally, subsection 128.1(1) treats an immigrating taxpayer as having reacquired each of the properties deemed to have been disposed of. Paragraph 128.1(1)(c) treats each of those properties as having been acquired, at a cost equal to its proceeds of disposition, at the particular time.

Immigration - Paid-up Capital

ITA 128.1(2) and (3)

Subsections 128.1(2) and (3) of the Act establish certain limits on the paid-up capital in respect of any class of the shares of a corporation that has immigrated to Canada. In general, subsection 128.1(2) is designated to ensure that an immigrating corporation's paid-up capital will not exceed the difference between the cost of its assets (as determined for Canadian tax purposes) and its outstanding liabilities. Subsection 128.1(3) restores any reduction in paid-up capital under subsection 128.1(2) to the extent that that reduction has previously been recognized as a deemed dividend on the shares in question.

Subsection 128.1(2) provides for a deduction from the paid-up capital in respect of any particular class of a corporation's shares. The deduction is computed as a proportion of the difference between two amounts. The first amount is the total of:

- the corporation's total paid-up capital (determined without reference to subsection 128.1(2));

- the corporation's liabilities; and

- any Part XIV investment allowance claimed by the corporation for its last taxation year.

The second amount is the total of:

- the corporation's deemed cost of properties under paragraph 128.1(1)(c);

- the cost amount of its other properties;

- the amount of what are commonly referred to as "resource pools"; and

- the paid-up capital in respect of its shares of connected Canadian corporations.

Where the first amount exceeds the second amount, a pro-rata portion of the difference is deducted from the paid-up capital in respect of any particular class of the corporation's shares.

New subsection 128.1(3) of the Act ensures that subsection 128.1(2)'s adjustments to the paid-up capital of a class of shares do not provide an inappropriate result where, because of a share redemption or reduction in paid-up capital, subsection 84(3), (4) or (4.1) of the Act subsequently treats the corporation as having paid a dividend on those shares. Where a deemed dividend arises on, for example, the redemption of some of the shares of a corporation subject to the subsection 128.1(2) adjustment, subsection 128.1(3) will provide for an addition to paid-up capital, such that the effect of the adjustment will remain constant in respect of the paid-up capital of the shares still outstanding.

Emigration

ITA 128.1(4)

New subsection 128.1(4) of the Act establishes a set of rules that apply to a taxpayer who ceases to be resident in Canada. These rules are largely symmetrical to the rules applied in new subsection 128.1(1) of the Act on becoming resident.

The time at which the taxpayer ceases to be resident in Canada is referred to, both in subsection 128.1(4) itself and in these notes, as the "particular time". The timing of other events provided for in subsection 128.1(4) is established by reference to that moment.

As is the case where one becomes resident in Canada, a taxpayer who ceases to be resident in Canada is treated as having disposed of property at the time immediately before the time immediately before the particular time, for proceeds equal to the property's fair market value. This deemed disposition, provided for by paragraph 128.1(4)(b), parallels the existing rule in section 88.1 in that it extends to all property where the taxpayer is not an individual. Where the taxpayer is an individual, certain types of property are exempted from the deemed disposition. These are, broadly speaking, types of property in respect of which Canada can expect to tax any gain realized on a later actual disposition. More specifically, the property not subject to the paragraph 128.1(4)(b) deemed disposition where an individual becomes non-resident includes taxable Canadian property, property used in a Canadian business, rights to receive pension or similar payments and employee stock options that are subject to section 7 of the Act.

Where the emigrant taxpayer is an individual other than a trust, the taxpayer may choose to vary the deemed disposition provided under paragraph 128.1(4)(b). First, under subparagraph 128.1(1)(b)(iv) the taxpayer may elect not to be treated as having disposed of any of the taxpayer's capital property, provided the taxpayer gives the Minister of National Revenue adequate security for any tax foregone as a result. Such property is, under paragraph 128.1(4)(e), treated as taxable Canadian property until it is disposed of or the taxpayer again becomes resident in Canada. This election parallels the one in existing paragraph 48(1)(c) of the Act. Second, the taxpayer may elect under paragraph 128.1(4)(d) to be treated as having disposed of taxable Canadian property or Canadian business inventory that would otherwise be exempt from the deemed disposition. This optional disposition may be compared to the result provided in existing paragraph 48(1)(a). Each of these new elections must be made in prescribed manner on or before the taxpayer's balance-due day for the taxation year that includes the particular time. It should also be noted that paragraph 128.1(4)(f), which is described more fully below, limits the extent to which losses may be created using the elections.

A further exception to the general rule that treats an emigrating taxpayer as having disposed of all the taxpayer's property is found in subparagraph 128.1(4)(b)(v). Where an individual other than a trust was resident in Canada for a total of no more than 60 months over the past 10 years, that individual is not treated as having disposed of any property owned when the individual last became resident here, or acquired by inheritance or bequest.

Immediately after the deemed disposition of the emigrating taxpayer's property - and thus immediately before the particular time - paragraph 128.1(4)(a) treats the taxpayer's taxation year as having ended, where the taxpayer is a corporation or a trust. A new year is deemed to have commenced at the particular time. This provision duplicates the result of existing section 88.1, and applies that result to trusts as well as corporations. Starting with the year that begins at the particular time, the emigrating corporation or trust may select a new fiscal period.

The final event deemed by new subsection 128.1(4) is the reacquisition by the taxpayer, at the particular time, of the property the taxpayer was deemed to have disposed of. Paragraph 128.1(4)(c) provides that the taxpayer will be treated as having reacquired that property at a cost equal to its proceeds of disposition.

As mentioned above, paragraph 128.1(4)(f) imposes limits on the use that may be made of the elective dispositions (and non-dispositions) of property made available to emigrant individuals other than trusts. These limits are designed to ensure that neither the optional exemption of a property under subparagraph 128.1(4)(b)(iv) nor its optional disposition under paragraph 128.1(4)(d) may be used to realize a loss exceeding any gain realized by the taxpayer on the disposition deemed to occur.

Where a taxpayer has elected under subparagraph 128.1(4)(b)(iv) or paragraph 128.1(4)(d), subparagraph 128.1(4)(f)(i) fixes a floor under the taxpayer's income for the taxation year in which the taxpayer ceased to be resident in Canada. The taxpayer's income is deemed to be the greater of (1) that income otherwise determined; and (2) the lesser of two amounts. The first amount is what the taxpayer's income would have been in the absence of subsection 128.1(4); the second amount is what the taxpayer's income would have been if the taxpayer had not chosen to vary the disposition by making an election. A similar rule in subparagraph 128.1(4)(f)(ii) limits the amount of the taxpayer's losses for that taxation year. Under this rule, the amount of any loss will be restricted to the lesser of: (A) the amount of the loss otherwise determined; and (B) the greater of: (I) the amount that the loss would be if subsection 128.1(4) did not apply and (II) the amount that it would be if subsection 128.1(4) did apply, but the taxpayer had made no elections.

Cross-border Mergers

ITA 128.2

Some corporate law systems allow the reorganization of corporations resident in different jurisdictions to form a single corporation. The tax consequences of such a reorganization may be uncertain, since the new corporation may be treated as a continuation of both a predecessor corporation resident in Canada, and a non-resident predecessor corporation. To clarify this situation, new section 128.2 of the Act treats all predecessor corporations as having had - or having adopted - the same residency status as the amalgamated corporation. Subsection 128.2(1) provides that where a corporation formed by any reorganization in respect of two or more predecessors is resident in Canada, any predecessor that was not, before the reorganization, itself resident in Canada is deemed to have become resident here immediately before the reorganization. Similarly, subsection 128.2(2) provides that a Canadian-resident predecessor is deemed to have become non-resident immediately before its reorganization into a new non-resident corporation.
Subsection 128.2(3), meanwhile, ensures that these rules do not apply to reorganizations occurring solely as a result of the acquisition by one corporation of another corporation's property, whether by way of purchase or on a winding-up of that other corporation.

Clause 63

Mutual Fund Corporations

ITA
131(6)

"non-qualifying real property"

Section 131 of the Act sets out rules relating to the taxation of mutual fund corporations and their shareholders. Subsection 131(6) contains a definition of "non-qualifying real property" of a corporation or a trust that is not a personal trust. This definition is used in determining the portion of a capital gain realized on the disposition of non-qualifying real property of a mutual fund corporation, investment corporation, mortgage investment corporation or a trust that is not a personal trust that may be eligible for the capital gains exemption in the hands of a shareholder to whom a capital gains dividend is paid or a beneficiary in respect of whom a designation is made under subsection 104(21.2) of the Act.

This amendment to the definition of non-qualifying real property provides that a share of the capital stock of a corporation will not constitute non-qualifying real property to a mutual fund corporation or trust where the value of the share is derived principally from real property owned by another corporation and the shares of that other corporation, if owned by the mutual fund corporation or trust, would not constitute non-qualifying real property to the mutual fund corporation or trust.

This amendment applies to the 1992 and subsequent taxation years.

Clause 64

Credit Unions

ITA
137(4.1) and (4.2)

Subsections 137(4.1) and (4.2) of the Act provide rules relating to the treatment of amounts paid or payable by a credit union in respect of a share of its capital stock. Subsection 137(4.1) provides that where such an amount (or in the case of an amount paid on the redemption, acquisition or cancellation of a share, the amount in excess of the paid-up capital of the share) is paid to a member of the credit union, the amount is treated as interest, rather than a dividend. Subsection 137(4.2) provides that subsections 84(2), (3) and (4) of the Act do not apply to deem an amount paid by a corporation that is a credit union, to any of its shareholders, to be a dividend.

Subsection 137(4.1) is amended to provide that an amount paid or payable by a credit union in respect of a share of its capital stock (or in the case of an amount paid on the redemption, acquisition or cancellation of the share, the amount in excess of the paid-up capital of the share), to a member of the credit union, will be deemed to be interest only where the share is not listed on a prescribed stock exchange. Consequential to this change, subsection 137(4.2) is amended to provide that, notwithstanding any other provision of the Act, an amount that is deemed to be interest under subsection 137(4.1) is deemed not to be a dividend. Accordingly, where, for example, a credit union redeems a share from a non-member, or redeems a share that is listed on a prescribed stock exchange from a member, subsection 84(4) will now apply to the redemption. However, subsection 84(4) will not apply to a payment that is made by a credit union, to a member of the credit union, in respect of a share of its capital stock that is not listed on a prescribed stock exchange. It is proposed that those stock exchanges listed in section 3200 of the *Income Tax Regulations* be prescribed for the purposes of subsection 137(4.1) of the Act.

These amendments apply to transactions occurring after December 21, 1992.

Clause 65

Subsidiary of Deposit Insurance Corporation

ITA
137.1(5.1)

Section 137.1 of the Act sets out rules relating to the taxation of deposit insurance corporations and their member institutions. Subsection 137.1(5.1) treats subsidiary wholly-owned corporations of deposit insurance corporations as being deposit insurance corporations for the purposes of that section, subject to certain enumerated exceptions, such as subsection 137.1(11). Paragraph 137.1(11)(b) provides that a member institution may deduct, in computing its income for a taxation year in which it repays to a deposit insurance corporation assistance received by it in a previous year, the amount of any such repayment, to the extent that the member institution has not chosen to exclude the repaid assistance from its income for that previous year by filing an amended return under subsection 137.1(12) of the Act.

Subsection 137.1(5.1) is amended, applicable to the 1992 and subsequent taxation years, to change the reference therein to subsection (11) to a reference to paragraph (11)(a). This amendment ensures that the deduction provided under paragraph 137.1(11)(b) will be available where assistance is repaid by a member institution to a subsidiary wholly-owned corporation of a deposit insurance corporation.

Clause 66

Insurance Corporations

ITA
138(12)

"surplus funds derived from operations"

Subsection 138(12) of the Act contains a definition of the term "surplus funds derived from operations" of an insurer for the purpose of the rules in section 138 applicable to insurance corporations. This definition also applies, with certain modifications, in determining the capital of a non-resident insurance corporation for the purposes of the special tax on large corporations under Part I.3 of the Act and the special tax on the capital of financial institutions under Part VI of the Act.

The definition of "surplus funds derived from operations" in subsection 138(12) is amended, effective for the 1992 and subsequent taxation years, to provide that these special taxes payable under Parts I.3 and VI may also be deducted in computing an insurer's surplus funds derived from operations.

Clause 67

Communal Organizations

ITA
143(1)(k)

Section 143 of the Act governs the taxation of communal organizations that do not permit members to own property in their own right. Subsection 143(1) provides that where such a communal organization or one or more business agencies (corporations, trusts or other persons) that it manages or controls carries on business in support of its members an *inter vivos* trust is deemed to exist. Paragraph 143(1)(d) deems the property of the communal organization and all its business agencies to be the property of the trust. Paragraph 143(1)(g) deems the communal organization and all its business agencies to act as agents for the trust in all matters relating to their business and other activities.

Paragraph 143(1)(k) of the Act is introduced to ensure that, where a communal organization (or one of its business agencies) is a corporation, the rules in paragraph 143(1)(d) and (g) will not preclude the corporation from issuing "small business development bonds" under section 15.1 of the Act. However, if the corporation is not an "eligible small business corporation" (as defined in subsection 15.1(3)) or fails to use proceeds from the issue of a bond in the manner described in subparagraph 15.1(1)(c)(ii), a trust deemed to exist pursuant to subsection 143(1) will be required to report additional amounts of income pursuant to paragraph 15.1(1)(c) and subsection 15.1(5).

This amendment applies to the 1992 and subsequent taxation years.

Clause 68

Employees Profit Sharing Plans

ITA
144

Section 144 of the Act provides rules applicable to "employees profit sharing plans" (EPSPs). An EPSP is defined in subsection 144(1). Under subsection 144(2), no tax is payable by an EPSP.

Subclause 68(1)

ITA
144(1) and (2)

An EPSP is defined in subsection 144(1) of the Act as an arrangement under which payments computed by reference to an employer's profit (or the profit from the business of a corporation with which the employer does not deal at arm's length) are made by the employer to a trustee under the arrangement. In addition, subsection 144(1) requires the trustee, contingently or absolutely:

- to allocate to employees all amounts received by the trustee from the employer (or a corporation with which the employer does not deal at arm's length),

- to allocate to employees all profits from trust property (computed without reference to capital gains or losses),

- to allocate to employees all capital gains and losses of the trust, and

- to reallocate to employees all amounts previously included in a former beneficiary's income by reason of a contingent allocation to the former beneficiary, where the former beneficiary has forfeited his or her right to the amount contingently allocated and, as a consequence, is deemed by subsection 144(9) to have paid an amount on account of tax under Part I of the Act.

Subsection 144(1) is amended to clarify that such allocations and reallocations are required to be made on an ongoing annual basis.

Subsection 144(1) is also amended to clarify that an individual who ceases to be an employee of an employer is not required to forfeit any amount under the employer's EPSP by reason of ceasing to be an employee. This clarification is achieved by eliminating the present closing words to subsection 144(1).

Amended subsection 144(1) provides that the rule concerning the reallocation referred to above makes a reference to amended subsection 144(9), which provides a former beneficiary who forfeits an amount under an EPSP with a deduction rather than a deemed payment of tax.

Finally, subsection 144(1) is amended to eliminate specific references to "officers". This amendment is appropriate because "officers" are considered to be "employees" for the purposes of the Act. (See the definition of "employee" in subsection 248(1) of the Act.)

Subsection 144(2) of the Act is amended so that no tax is payable by a trust governed by an EPSP on the taxable income of the trust for a taxation year only if the trust was governed by the EPSP throughout the year.

The amendments to subsection 144(1) apply to the 1992 and subsequent taxation years. However, because the existing definition might be construed so that profits and gains need not be allocated before paid out, a transitional rule will treat such amounts paid out before 1993 as having been allocated. The amendment to subsection 144(2) applies to the 1993 and subsequent taxation years.

Subclauses 68(2) and (3)

ITA
144(3) and (8.2)

Under subsection 144(1) of the Act, the trustee of an EPSP is required to allocate profits from trust property (including interest) to employees. Subsection 144(8.2) (read in conjunction with paragraph 144(3)(f)) provides that interest included in computing the income of a trust governed by an EPSP for a year is treated as interest income of a beneficiary under the trust, to the extent that the trust allocates such interest income in favour of that beneficiary. The flow-through of interest income was relevant for the purposes of the $1,000 investment income deduction, which was provided under former section 110.1 of the Act.

Subsection 144(8.2) and paragraph 144(3)(f) are repealed. As a consequence, interest income of a trust allocated to a beneficiary is included in the beneficiary's income pursuant to subsection 144(3) without any flow-through of the character of that income.

These amendments apply to the 1992 and subsequent taxation years, except that a beneficiary may elect that these amendments not apply to the 1992 taxation year by notifying the Minister of National Revenue by the end of the sixth month after the month in which Royal Assent to these amendments occurs.

Subclause 68(4)

ITA
144(9) and (10)

Subsection 144(9) of the Act applies where an employee ceases to be a beneficiary under a trust governed by an EPSP and, as a consequence, forfeits his or her entitlement to amounts that were previously allocated by the trustee of the trust and included in computing the employee's income. In these circumstances, the employee is treated as having paid 15% of the forfeited amount on account of federal income tax under Part I.

Subsection 144(9) is amended so that it applies where a "person", rather than an "employee", ceases to be a beneficiary under a trust governed by an EPSP. This change of reference clarifies that subsection 144(9) will not apply to an individual merely because the individual dies and the individual's estate or heirs become entitled to benefits under the plan. In this context, it should be noted that a "person" under subsection 248(1) of the Act includes not only an individual but the estate or heirs or legal representatives of that individual. In the event that a forfeiture occurs after the death of an employee, it is intended that the estate or the heir would be entitled to benefit from subsection 144(9) and take into account amounts previously allocated to the employee.

Subsection 144(9) is also amended so that it no longer provides a deemed payment of tax equal to 15% of the forfeited amount. Instead, amended subsection 144(9) provides that the forfeited amount qualifies for a deduction in computing a person's income. Under paragraph 8(1)(o.1), this deduction is taken into account in computing a person's income from employment.

Subsection 144(9) is also amended to ensure that, where taxable dividends have been allocated to an employee and those amounts are subsequently forfeited, the "gross-up" for the dividends under paragraph 82(1)(b) (presently equal to 25% of the allocation) that has been added in computing an employee's income is ignored for the purposes of determining the forfeited amount that can be deducted under subsection 144(9). In addition, subsection 144(9) is amended so that 1/4 of all such taxable dividends allocated to an employee reduce the amount that can be deducted under the amended subsection. The amendments with respect to the forfeiture of dividends recognize that the gross-up and dividend tax credit mechanism provided under paragraph 82(1)(b) and section 121 results in a lower effective tax rate for dividends allocated to employees than for other income so allocated.

Subsection 144(9) is also amended to ignore any forfeited amount to the extent that it represents a capital gain that was previously allocated to a beneficiary under subsection 144(4). This amendment reflects the fact that such an allocation would typically not result in any income tax for a beneficiary because of the capital gains exemption provided under section 110.6.

Subsection 144(9) is also amended to clarify its application when an employee forfeiting an amount under an EPSP subsequently rejoins the plan. In the event that the employee rejoins in the year of the forfeiture, any recognition of the forfeiture under amended subsection 144(9) is delayed until the employee subsequently ceases to be a beneficiary under the plan. In the event that the employee rejoins the plan after the year of the forfeiture, amended subsection 144(9) ensures that the forfeited amount cannot be deducted in computing the employee's income for a taxation year subsequent to the year of the forfeiture.

These amendments apply to the 1992 and subsequent taxation years, except that a beneficiary may elect that they not apply to the 1992 taxation year by notifying the Minister of National Revenue by the end of the sixth month after the month in which Royal Assent to these amendments occurs. (It is not anticipated that the election will be widely used, as amended subsection 144(9) will provide significantly greater relief than the existing law in most cases.)

Subsection 144(10) of the Act allows an employer to elect to have an arrangement under which payments are stipulated to be made "out of profits" to be treated, for the purposes of the EPSP rules, as an arrangement under which payment are computed by reference to the profits of the employer. Thus, such an arrangement may qualify as an EPSP provided the allocation and reallocation requirements set out in subsection 144(1) are satisfied.

Subsection 144(10) is amended so that its wording corresponds to amended subsection 144(1). This amendment applies to the 1992 and subsequent taxation years.

Clause 69

Registered Retirement Savings Plans

ITA
146

Section 146 of the Act provides rules governing the treatment of registered retirement savings plans (RRSPs).

Subclause 69(1)

ITA
146(1)

"net past service pension adjustment"

Subsection 146(1) of the Act contains a definition of a taxpayer's net past service pension adjustment (net PSPA) for the purpose of computing the taxpayer's RRSP deduction limit and the taxpayer's unused RRSP deduction room. A taxpayer's net PSPA for a year is equal to the total of the taxpayer's past service pension adjustments (PSPAs) for the year minus the taxpayer's PSPA withdrawals for the year as determined by regulation.

The definition is amended, effective for the 1993 and subsequent taxation years, to include in a taxpayer's net PSPA any amounts prescribed for this purpose. This change is made as a consequence of the amendments which will be made to the *Income Tax Regulations* to add rules dealing with "government-sponsored retirement arrangements". In general terms, a government-sponsored retirement arrangement is a retirement plan established for individuals who are not employees of a government or other public body but who are paid from public funds for services they render. Amounts similar to pension adjustments (PAs) and past service pension adjustments (PSPAs) will be reportable in respect of such arrangements. The PA-type amounts will be prescribed for the purpose of the definitions of RRSP dollar limit and unused RRSP deduction room, while the PSPA-type amounts will be prescribed for inclusion in net PSPA. For further information, see the commentary on proposed section 8308.4 of the Regulations, included in the draft amendments to the Regulations released by the Minister of Finance on December 18, 1992.

Subclause 69(2)

ITA
146(1)

"refund of premiums"

Subsection 146(1) of the Act contains a definition of "refund of premiums", which is relevant in determining the amount that, on the death of an annuitant under an RRSP, is included in computing a qualifying individual's income rather than the annuitant's income. In certain cases, the "refund of premiums" may be transferred by the qualifying individual under paragraph 60(l) to acquire a qualifying annuity, or to an RRSP or a RRIF. A "refund of premiums" under an RRSP in respect of a qualifying individual is an amount paid to the qualifying individual out of the RRSP as a consequence of the death of the RRSP annuitant. A spouse of the deceased annuitant is a qualifying individual unless the deceased annuitant died after the maturity of the plan. Financially dependent children and grandchildren of the deceased annuitant are qualifying individuals if the deceased annuitant had no spouse at the time of death.

The definition of "refund of premiums" is amended to clarify the computation of a "refund of premiums" where an annuitant under an RRSP dies prior to its maturity, but the payment under the RRSP to a spouse of the annuitant is made after the date that the RRSP would otherwise have converted into an annuity. In these circumstances, the amended definition ensures that such payments are not disqualified as a "refund of premiums" to the surviving spouse.

The definition is further amended to clarify that an amount will qualify as a "refund of premiums" in respect of an RRSP only when the amount is paid out of the RRSP after the death of an annuitant under the RRSP.

These amendments apply with respect to deaths occurring after 1992.

Subclause 69(3)

ITA
146(4)(b) and (c)

Subsection 146(4) of the Act generally provides that no income tax is payable by trusts governed by RRSPs except in specified circumstances. This exemption does not, however, extend to income from the carrying on of a business or to income for taxation years after the taxation year in which the last annuitant under the RRSP dies.

Paragraph 146(4)(b) is amended so that this exemption extends to business income from, or from the disposition of, a qualified investment for RRSPs. The amendment recognizes that business income may be allocated to units in limited partnerships that are held by RRSPs. The amendment also recognizes that the disposition of qualified investments by RRSPs may, in some circumstances, result in business income.

Paragraph 146(4)(c) is amended so that tax is no longer payable by a trust governed by an RRSP for the taxation year immediately following the taxation year in which the last annuitant dies. Instead, tax will become payable in the second following taxation year.

These amendments apply to the 1993 and subsequent taxation years.

Subclause 69(4)

ITA
146(5)(a)

Subsection 146(5) of the Act provides that the amount an individual may deduct in computing income for a taxation year cannot exceed the lesser of two amounts. The first amount is the individual's RRSP deduction limit for the year. The second amount, as determined under paragraph 146(5)(a) is, in general terms, the undeducted pool of the individual's post-1990 RRSP contributions made on or before the 60th day of the following taxation year. In computing this second amount for a taxation year ending after 1992, paragraph 146(5)(a) provides that amounts deducted under subsection 147.3(13.1) for the year must be also be subtracted from this amount.

Subsection 147.3(13.1) applies in the event that amounts have been transferred from a registered pension plan to an RRSP or a RRIF in excess of the limits set out in section 147.3. In these circumstances, the excess amount is deemed to be an RRSP contribution made at the time of the transfer. However, subsection 147.3(13.1) provides that this amount (to the extent not deducted under subsection 146(5)) can be carried forward for deduction by an individual in a taxation year against specified amounts of RRSP and RRIF income included in computing the individual's income for the year.
Subsection 147.3(13.1) applies in respect of RRSP contributions (including deemed RRSP contributions) made after 1988.

Paragraph 146(5)(a) is amended to provide that a deduction in a taxation year under subsection 147.3(13.1) will not be subtracted in computing the undeducted post-1990 RRSP contributions pool, to the extent the deduction can be considered to relate to RRSP contributions made or deemed to be made in 1989 or 1990.

This amendment applies to the 1992 and subsequent taxation years.

Subclause 69(5)

ITA
146(5.1)

Subsection 146(5.1) of the Act sets out the rules governing the deductibility of premiums paid by a taxpayer to an RRSP under which the taxpayer's spouse is the annuitant. The deduction permitted for a taxation year is the undeducted portion of the taxpayer's post-1990 RRSP premiums, up to the portion of the taxpayer's RRSP deduction limit for the year that has not been used as the basis for the deduction of RRSP premiums paid by the taxpayer to RRSPs under which the taxpayer is the annuitant.

Subsection 146(5.1) is amended so that, where an individual dies in a taxation year or within 60 days after the end of the year, a deduction under the subsection may be claimed on behalf of the individual for the year for RRSP premiums paid on behalf of the individual to an

RRSP under which the individual's widow or widower is the annuitant.

This amendment applies to the 1992 and subsequent taxation years.

Subclause 69(6)

ITA
146(8.2)(b)

Subsection 146(8.2) of the Act is a relieving measure which provides a deduction for RRSP or RRIF distributions included in computing an individual's income that are in respect of certain non-deducted RRSP premiums paid by the individual to the individual's own RRSP or to a spousal RRSP.

Paragraph 146(8.2)(b) is amended to ensure that such non-deducted RRSP premiums do not include RRSP premiums paid by way of a transfer from prescribed provincial pension plans (i.e. the Saskatchewan Pension Plan) in circumstances to which new subsection 146(21) applies.

This amendment applies to the 1992 and subsequent taxation years.

Subclause 69(7)

ITA
146(8.8)(b)

Subsection 146(8.8) of the Act provides that, where an individual dies, there is included in computing the individual's income the fair market value of the individual's RRSP assets at the time of the death minus "the portion thereof" that becomes receivable by the individual's spouse. If the RRSP has been converted into an annuity, the latter amount is determined on the assumption that the surviving spouse lives throughout any guaranteed terms contained in the annuity. The income inclusion determined under subsection 146(8.8) may, in certain cases, be reduced by the operation of subsection 146(8.9) of the Act (discussed below).

Paragraph 146(8.8)(b) is amended so that an amount is deducted thereunder in respect of an amount receivable by an RRSP annuitant's spouse only where the annuitant dies after the RRSP has matured into an annuity. Instead, amended subsection 146(8.9) provides for a reduction of the amount determined under subsection 146(8.8) where the annuitant dies before the RRSP matures into an annuity.

Subsection 146(8.8) is also amended to clarify that, in determining the income inclusion for a deceased annuitant, the amount deducted under that subsection is equal to the fair market value at the time of the annuitant's death of the portion of the RRSP property that becomes receivable by the individual's spouse.

These amendments apply with respect to deaths occurring after 1992.

Subclause 69(8)

ITA
146(8.9)

Subsection 146(8.9) of the Act provides a reduction of the amount otherwise included in a deceased RRSP annuitant's income for the year of death under subsection 146(8.8). Subsection 146(8.9) of the Act currently applies only in two cases. The first case is where an amount is paid out of an RRSP to the annuitant's estate that is deemed to be a "refund of premiums" because of a joint election under subsection 146(8.1) by the legal representative of the deceased annuitant and a qualifying beneficiary of the estate. The second case is where a child or grandchild is paid an amount that qualifies as a "refund of premiums". In these cases, such payments are deducted in computing the annuitant's income for the year of death.

Subsection 146(8.9) is amended so that it also applies in a third case, namely where a spouse of a deceased annuitant receives an amount that qualifies as a "refund of premiums". This amendment is strictly consequential on the first amendment to subsection 146(8.8) of the Act, described above. As a consequence, it is no longer necessary to distinguish in subsection 146(8.9) between "refunds of premiums" and deemed "refunds of premiums", as they are treated in the same manner under subsection 146(8.9).

Subsection 146(8.9) is also amended to allow a deceased individual's legal representatives to claim any amount less than the amount determined under subsection 146(8.9) to offset the deceased individual's income inclusion on death under subsection 146(8.8). By virtue of the application of paragraph (a) of the definition of "benefit" in subsection 146(1) of the Act, this would have the advantage of increasing the amount from the RRSP that can be distributed on a tax-free basis to RRSP beneficiaries.

Subsection 146(8.9) is also amended in order to minimize the effect of the growth of RRSP assets after the death of an RRSP annuitant on the calculation of the RRSP annuitant's income for the year of death. This amendment effectively provides that the amount deducted under this subsection in computing such income is reduced by a specified fraction of post-death growth that is considered to be part of the refunds of premiums. For this purpose, the total growth in RRSP assets after the death of an RRSP annuitant is considered to be the amount, if positive, equal to:

- the total payments (referred to below as the "relevant payments") out of or under the RRSP after the annuitant's death and before the later of the end of the first calendar year commencing after the death and the time immediately after the distribution of all refunds of premiums,

- plus the fair market value of property of the RRSP at the later of the two times described above (referred to below as the "residual value", this amount will almost always be nil),

- minus the fair market value of all the property of the RRSP at the time of the annuitant's death.

The specified fraction of that growth with respect to an RRSP is the total of such refunds from the RRSP divided by the sum of the RRSP's residual value and the relevant payments under the RRSP. The example below illustrates the operation of this amendment.

These amendments apply with respect to deaths occurring after 1992.

EXAMPLE

Paul dies in 1993. He has an unmatured RRSP, with assets having a fair market value of $40,000 at the time of his death. One year after his death, the RRSP assets (now having a fair market value of $50,000) are paid to Paul's estate. Paul's widow and the legal representative of the estate make an election under subsection 146(8.1) to treat $30,000 of this amount as a refund of premiums for Paul's widow. The legal representative of the estate claims the maximum deduction under subsection 146(8.9).

Result:

1. The income inclusion for Paul for the taxation year of his death is $16,000 by virtue of subsection 146(8.8) and amended subsection 146(8.9) (40,000 - (30,000(1 - (50,000 - 40,000)/50,000)).

2. Paul's widow has an income inclusion of $30,000, although this income inclusion may be offset by virtue of a transfer of funds to which paragraph 60(l) of the Act applies.

3. The estate has an income inclusion of $4,000. (50,000 - 16,000 - 30,000).

4. If the law were not amended, the income inclusions for Paul, Paul's widow and the estate would be $10,000, $30,000 and $10,000, respectively. The amendments thus have the effect of reallocating income inclusions on death and do not increase the total amounts included in computing income.

Subclause 69(9)

ITA
146(20)

Subsection 146(20) of the Act applies in the case of an RRSP that is a deposit with a financial institution. It provides that the mere crediting of interest in respect of that deposit does not constitute the receipt of that interest by the RRSP annuitant, provided that the annuitant is alive in the year in which the interest is credited.

Subsection 146(20) is amended in two respects. First, it is amended so that it also applies to the year following the year in which the annuitant died. Second, amended subsection 146(20) prevents an income inclusion by such crediting for a person other than the RRSP annuitant (i.e., the RRSP annuitant's estate or heirs). The amendments to subsection 146(20) are consistent with the amendments on death with respect to trusteed RRSPs in paragraph 146(4)(c) of the Act and with a proposed amendment to subsection 7000(6) of the *Income Tax Regulations* that was released on December 21, 1992.

These amendments apply with respect to deaths occurring after 1992.

Subclause 69(10)

ITA
146(21)

New subsection 146(21) of the Act allows lump sum amounts from prescribed provincial pension plans (i.e. the Saskatchewan Pension Plan) to be transferred directly from such a plan on behalf of an individual to RRSPs or RRIFs under which the individual is an annuitant. Such amounts may also be transferred to RRSPs or RRIFs under which the individual's spouse or former spouse is the annuitant, if the two individuals are living separate and apart and the payment or transfer is made under a judicial order or decree or a written separation agreement relating to a division of property between the two individuals on the breakdown of their relationship. In addition, such amounts may be transferred to acquire an annuity described in paragraph 60(l) of the Act for the benefit of the individual or, where the annuity is acquired in connection with a division of property described above, the individual's spouse or former spouse.

In these circumstances, new subsection 146(21) generally provides that the transferred amount is not included in an individual's income and no deduction in computing the individual's income may be made with respect to the transferred amount. However, new subsection 146(21) does not apply in respect of the transfer of benefits arising as a consequence of the death of any individual (other than the individual on whose behalf the transfer is made, or the spouse or former spouse of such individual).

For the purposes of new subsection 146(21), a spouse includes a common-law spouse. After 1992, this is a result of the application of subsection 252(4) of the Act. In 1992, this is a result of the application of subsection 146(1.1) of the Act, which is being repealed as a consequence of the introduction of subsection 252(4).

This amendment applies to transfers occurring after 1991. However, where a taxpayer has elected to have existing paragraph 60(l) apply in respect of a transfer in 1992, the amendment applies in respect of transfers made on behalf of the taxpayer after 1992.

Clause 70

Home Buyers' Plan

ITA
146.01(1)

Subsection 146.01(1) of the Act sets out definitions which apply for the purposes of the Home Buyers' Plan. An "excluded premium" is a specified type of RRSP contribution. Under subsection 146.01(3), an excluded premium is not allowed to be treated as a repayment of an amount withdrawn under the Home Buyers' Plan. Under subsection 146.01(9) (as well as proposed subsection 146.01(10) contained in Bill C-9), this type of RRSP contribution may be made by an individual without resulting in an income inclusion for an individual who has made an RRSP withdrawal under the Home Buyers' Plan.

The definition of "excluded premium" is amended so that amounts transferred directly from a prescribed provincial pension plan (i.e. the Saskatchewan Pension Plan) to an RRSP are included within the definition.

This amendment applies to the 1992 and subsequent taxation years.

Clause 71

Registered Retirement Income Funds

ITA
146.3

Section 146.3 of the Act contains the rules for registered retirement income funds (RRIFs).

Subclause 71(1)

ITA
146.3(1)

"retirement income fund"

Subsection 146.3(1) of the Act contains a definition of "retirement income fund". This amendment to the definition of retirement income fund removes the requirement that, at the end of the year in which the last payment under a retirement income fund is made, a payment equal to the value of the property held in connection with the fund be paid out. This requirement is no longer necessary because the application of the new definition of "designated benefit" in subsection 146.3(1) of the Act allows payments to be made from such a fund throughout the lifetime of a RRIF annuitant.

This amendment applies to the 1992 and subsequent taxation years. However, in the case of a RRIF entered into before March 1986 and not revised or amended before 1992, it applies only once the RRIF is revised or amended.

Subclause 71(2)

ITA
146.3(1)

"designated benefit"

The introduction of the new definition "designated benefit" in subsection 146.3(1) of the Act is discussed in the commentary on the amendments to subsections 146.3(6.1) and (6.11).

Subclause 71(3)

ITA
146.3(2)(f)

Subsection 146.3(2) of the Act sets out the conditions that must be satisfied by a retirement income fund for it to be registered. Paragraph 146.3(2)(f) prohibits such a fund from receiving property, other than property transferred from sources listed in that paragraph.

Paragraph 146.3(2)(f) is amended, applicable after 1991, so that a retirement income fund of which an individual is the annuitant may receive property transferred directly from a prescribed provincial pension plan (i.e. the Saskatchewan Pension Plan) in circumstances to which new subsection 146(21) applies.

Subclause 71(4)

ITA
146.3(3)

Subsection 146.3(3) of the Act generally provides that no income tax is payable by trusts governed by RRIFs except in specified circumstances. This exemption does not, however, extend to income from the carrying on of a business.

Paragraph 146.3(3)(e) is amended so that this exemption extends to business income from, or from the disposition of, a qualified investment for RRIFs. The amendment recognizes that business income may be allocated to units in limited partnerships that are held by RRIFs. The amendment also recognizes that the disposition of qualified investments by RRIFs may, in some circumstances, result in business income.

This amendment applies to the 1993 and subsequent taxation years.

Subclause 71(5)

ITA
146.3(3.1)

Subsection 146.3(3.1) of the Act provides that the income tax exemption for trusts governed by RRIFs ends after the year in which the last annuitant under the RRIF dies.

Subsection 146.3(3.1) is amended so that the exemption is extended until the end of the year immediately following the year in which the last annuitant under the RRIF dies. This is consistent with a similar amendment to paragraph 146(4)(c), dealing with the income tax exemption for trusts governed by RRSPs.

This amendment applies to the 1993 and subsequent taxation years.

Subclause 71(6)

ITA
146.3(6)

Subsection 146.3(6) of the Act provides that, where an individual who is the last annuitant under a RRIF dies, there is included in computing the individual's income the fair market value of the individual's RRIF assets at the time of the death minus "the portion thereof" that becomes receivable by the individual's spouse. The income inclusion otherwise determined under subsection 146.3(6) may, in certain cases, be reduced by the operation of subsection 146.3(6.2) of the Act (discussed below). In addition, subsection 146.3(6) has no application should the deceased individual's spouse become the annuitant under the RRIF as contemplated in the definition of "annuitant" in subsection 146.3(1) of the Act.

Subsection 146.3(6) is amended so that no amount is deducted under that subsection in respect of an amount receivable by a spouse of the last annuitant under a RRIF. Instead, amended subsection 146.3(6.2) provides for a reduction of the amount otherwise determined under subsection 146.3(6) where an amount becomes receivable by the annuitant's spouse. These amendments are parallel to amendments to subsections 146(8.8) and (8.9) of the Act.

This amendment applies with respect to deaths occurring after 1992.

ITA
146.3(6.1) and (6.11)

Subsection 146.3(6.1) of the Act provides that an amount paid out of a RRIF to the last annuitant's legal representative after the death of the RRIF annuitant will, as a consequence of a joint election by the legal representative and the beneficiary, be treated in the hands of the beneficiary as a "benefit" that is a "refund of premiums" under an RRSP, provided that the amount so paid out would have qualified as a "refund of premiums" if the RRIF had been an RRSP. As a result, such deemed "refunds of premiums" are included under the existing rules in computing a beneficiary's income pursuant to subsection 146(8) and, in certain cases, may be transferred by the beneficiary pursuant to paragraph 60(l) of the Act. The reference to the "refund of premiums" rule ensures that children and grandchildren of the last annuitant will be the subject of an election under subsection 146.3(6.1) only if they were financially dependent on the last annuitant and the last annuitant had no spouse at the time of death.

The term "designated benefit" is newly defined in subsection 146.3(1) of the Act. A "designated benefit" of an individual is one of two types of RRIF distributions. The first type of distribution is the type of distribution currently described in subsection 146.3(6.1) that is the subject of a joint election made by the individual and the legal representative of the last annuitant under a RRIF, except that the new definition ensures that such an election is available to a surviving spouse in the event that such spouse does not become an annuitant under the RRIF. The second type of distribution is a distribution from the RRIF made directly to a spouse, child or grandchild of the last annuitant that would have qualified as a "refund of premiums" if the RRIF had been an RRSP which had not yet matured.

Subsection 146.3(6.1) is amended so that the first type of "designated benefit" of a beneficiary is treated as a RRIF distribution made directly to the beneficiary, rather than as a "refund of premiums". As a consequence, the designated benefit would generally be included in the beneficiary's income under subsection 146.3(5) of the Act rather than in the income of the deceased's estate. (However, paragraph 146.3(5)(b) prevents double taxation in the unusual case that a trust governed by a RRIF makes a distribution of already-taxed income.)

Subsection 146.3(6.11) of the Act is introduced to allow part of a designated benefit (referred to below as an "eligible amount") of an individual in respect of a RRIF to be transferred by the individual, directly or indirectly, to an RRSP, RRIF or annuity issuer under paragraph 60(l). This amendment is, in part, consequential on amendments to subsections 146.1(6.1) and (6.2) under which RRIF distributions are no longer characterized as "refunds of premiums". The amendment also ensures that the eligible amount must be determined with reference to the minimum amount under the RRIF for the year. In addition, the amendment also ensures that the spouse of the last annuitant is, under paragraph 60(l) of the Act, able to transfer RRIF distributions (whether or not such distributions are transferred directly to another RRIF, an RRSP or an annuity issuer.)

More specifically, new subsection 146.3(6.11) provides that an "eligible amount" of an individual in respect of a RRIF for the purposes of paragraph 60(l) for a taxation year is nil, unless the individual is the spouse of the last annuitant under the fund or is a child or grandchild of the last annuitant who was dependent on the annuitant by reason of physical or mental infirmity. (The infirmity requirement is consistent with existing clause 60(l)(v)(B).) In the latter two cases, the eligible amount of the individual in respect of the fund for a taxation year is the "designated benefit" of the individual in respect of the RRIF for the year minus a specified proportion of the "designated benefit". The specified proportion is equal to the minimum amount under the fund for the year (other than any portion thereof included in computing the income of an annuitant under the fund for the year) divided by the total "designated benefits" in respect of the fund for the year.

These amendments apply with respect to deaths occurring after 1992.

ITA
146.3(6.2)

Subsection 146.3(6.2) of the Act provides a reduction of the amount included in a deceased RRIF annuitant's income for the year of death under subsection 146.3(6). The reduction provided under subsection 146.3(6.2) currently applies only in two cases. The first case is where an amount is paid out of a RRIF to the annuitant's estate that, because of a joint election by the legal representative of the deceased annuitant and a qualifying beneficiary of the estate under subsection 146.3(6.1), is deemed to be paid to the qualifying beneficiary. The second case is where a child or grandchild is paid an amount that would qualify as a "refund of premiums" if the RRIF had been an RRSP. In these cases, such payments are deducted in computing the annuitant's income for the year of death. Subsection 146.3(6.2) also currently provides that the latter amount paid to a child or grandchild is deemed to be a "refund of premiums" under an RRSP, thus allowing a transfer of such amount under paragraph 60(l) by the child or grandchild in some cases.

Subsection 146.3(6.2) is amended (in conjunction with the introduction of the definition "designated benefit" in subsection 146.3(1) of the Act) so that it applies to a RRIF annuitant in all cases where there is a "designated benefit" of an individual in respect of the RRIF. In particular, the amended subsection now also applies where a spouse of a deceased annuitant receives a RRIF distribution. This amendment is consequential on the first amendment to subsection 146.3(6), described above.

Subsection 146.3(6.2) is also amended to allow a deceased individual's legal representatives to claim any amount less than the amount determined under subsection 146.3(6.2) to offset the deceased individual's income inclusion on death under subsection 146.3(6). By virtue of the application of paragraph 146.3(5)(a), this would have the advantage of increasing the amount from the RRIF that can be distributed on a tax-free basis to RRIF beneficiaries.

Subsection 146.3(6.2) is also amended in order to minimize the effect of the growth of RRIF assets after the death of last annuitant on the calculation of the last annuitant's income for the year of death. This amendment effectively provides that the amount deducted under this subsection in computing such income is reduced by a specified fraction of post-death growth that is considered to be part of "designated benefits". For this purpose, the total growth in RRIF assets after the death of the last annuitant is considered to be the amount, if positive, equal to:

- the total payments (referred to below as the "relevant payments") out of the RRIF after the last annuitant's death and before the later of the time immediately after the distribution of all "designated benefits" and the end of the first calendar year commencing after the last annuitant's death,

- plus the fair market value of property of the RRIF at the later of the two times described above (referred to below as the "residual value", this amount will almost always be nil),

- minus the fair market value of all the property of the RRIF at the time of the annuitant's death.

The specified fraction of that growth with respect to a RRIF is the total of such designated benefits from the RRIF divided by the sum of the RRIF's residual value and the relevant payments under the RRIF. The operation of a similar amendment to the RRSP rules is illustrated in the commentary to amended subsection 146(8.9) of the Act.

Subsection 146.3(6.2) is also amended so that RRIF distributions to children and grandchildren are not deemed to be "refunds of premiums". Such amounts will, instead, be treated as RRIF distributions which are generally included in income under subsection 146.3(5). However, new subsection 146.3(6.11) of the Act does allow all or part of such amounts to be transferred under paragraph 60(l) in cases of physical or mental infirmity.

These amendments apply in respect of deaths occurring after 1992.

Subclause 71(7)

ITA
146.3(15)

Subsection 146.3(15) of the Act applies in the case of a RRIF that is a deposit with a financial institution. It provides that the mere crediting of interest in respect of that deposit does not constitute the receipt of that interest by the RRIF annuitant, provided that the annuitant is alive in the year in which the interest is credited.

Subsection 146.3(15) is amended in two respects. First, it is amended so that it also applies to the year following the year in which the annuitant died. Second, amended subsection 146.3(15) prevents an income inclusion by such crediting for a person other than the RRSP annuitant (i.e. the RRSP annuitant's estate or heirs). The amendments to subsection 146.3(15) are consistent with the amendments on death with respect to trusteed RRSPs in subsection 146.3(3.1) of the Act and with a proposed amendment to subsection 7000(6) of the *Income Tax Regulations* that was released on December 21, 1992. The amendments are also consistent with amendments to a similar rule with respect to RRSPs in subsection 146(20).

These amendments apply in respect of deaths occurring after 1992.

Clause 72

Deferred Profit Sharing Plans

ITA
147(2)(c) and (d)

Section 147 of the Act contains the rules relating to deferred profit sharing plans (DPSPs). Paragraph 147(2)(c) of the Act requires that, as a condition of registration, a deferred profit sharing plan (DPSP) provide that no part of the funds of the trust governed by the plan may be invested in notes, bonds, debentures or similar obligations of an employer who makes payments under the plan for the benefit of beneficiaries under the plan, or of a corporation with whom that employer does not deal at arm's length. Similarly, paragraph 147(2)(d) requires that a DPSP provide that no part of the funds of the trust governed by the plan may be invested in shares of a corporation, if 50% or more of the property of the corporation consists of such obligations.

Paragraphs 147(2)(c) and (d) are amended to add bankers' acceptances to the obligations described in those paragraphs, effective for the 1993 and subsequent taxation years.

Clause 73

Life Insurance Policies

ITA
148(1)(e)

Subsection 148(1) of the Act requires the inclusion in income of certain amounts from the disposition of a life insurance policy (including annuities), with certain exceptions. Paragraph 148(1)(e) excepts from this rule income from the disposition of an annuity the cost of which was deductible under paragraph 60(l).

Paragraph 148(1)(e) is amended to extend this exception to annuities acquired in circumstances to which subsection 146(21) of the Act applies. That subsection allows amounts to be transferred from prescribed provincial pension plans to acquire an annuity described in paragraph 60(l) of the Act.

This amendment applies to dispositions occurring after August 1992.

Clause 74

Charities

ITA
149.1

Section 149.1 of the Act sets out the rules relating to charities that must be registered by the Minister of National Revenue.

Subclauses 74(1), (2), (3) (4) and (6)

ITA
149.1(1), (2) and (21)

Subsection 149.1(1) of the Act contains the definition of "disbursement quota" that applies to charitable foundations. Parts of this definition also apply to charitable organizations, as provided for in subsection 149.1(2) of the Act. The disbursement quota rules require that both charitable foundations and organizations annually spend a specified proportion of the donations for which they issue tax receipts and, in the case of foundations, a specified percentage of the value of investment assets, on charitable activities or gifts to other charities.

Certain types of donations to charities may not be available to be spent during the year in which they are donated. For this reason, gifts of capital received through bequests or inheritances, and gifts received subject to binding instructions that they not be spent for at least ten years are excluded from the disbursement quota calculation in the year of receipt. However, such gifts may ultimately be spent by a charity at a future time and it is appropriate that, at such a time, these gifts be included in the disbursement quota calculation.

The definition of "disbursement quota" in subsection 149.1(1) of the Act is amended to ensure that gifts that have been previously excluded from the disbursement quota are added back into the calculation when they are actually spent by a charity. This amendment applies to gifts of capital received through bequests or inheritances in taxation years beginning after 1992, and to gifts subject to binding instructions that are spent in taxation years beginning after 1992.

Consequential amendments are also being made to paragraphs 149.1(2)(b) and (21)(c) of the Act to include references to the relevant amended portion of this definition.

Subclause 74(5)

ITA
149.1(8)

Subsection 149.1(8) of the Act allows a charity that obtains approval from the Minister of National Revenue to accumulate property for a particular purpose. Property so accumulated by a charity in any year is deemed to have been expended in that year on charitable activities carried on by the charity. This condition is necessary to ensure that a charity may still meet the disbursement quota that it is subject to under the provisions of subsection 149.1(1) of the Act while it is accumulating such property.

This amendment to subsection 149.1(8) provides that accumulated property will be deemed not to have been expended by a charity in any year other than the year in which the property is accumulated. This amendment recognizes that, because accumulated property is deemed to be expended in the year it is accumulated, it is not appropriate to provide a subsequent counting of the same property in a charity's disbursement quota calculation in the year when the accumulated property is actually expended.

This amendment applies to years beginning after 1992.

Clause 75

Electronic Filing of Returns

ITA
150.1

Section 150.1 of the Act provides for the use of electronic media for filing tax returns. Subsection 150.1(4) provides that persons filing tax returns electronically on behalf of other persons shall, if required by regulation, obtain signed statements in prescribed form from those persons on whose behalf such returns are filed.

Amended subsection 150.1(4) of the Act requires, instead, a person on whose behalf a return is filed electronically to complete an information return in prescribed form and containing prescribed information, to keep a copy, and to give the signed original to the person filing the return.

This amendment applies after 1991.

Clause 76

Assessments and Reassessments

ITA
152

Section 152 of the Act contains rules relating to assessments and reassessments of tax, interest and penalties payable by a taxpayer and to determinations and redeterminations of tax deemed to have been paid by a taxpayer.

Subclause 76(1)

ITA
152(1)(b)

Subsection 152(1) of the Act requires the Minister of National Revenue to assess a person's income tax and to determine the amount of tax deemed to have been paid by the person under subsection 144(9) and other provisions of the Act on account of the person's income tax.

Paragraph 152(1)(b) is amended to delete the reference to subsection 144(9), strictly as a consequence of the amendment to that subsection. This amendment applies to the 1993 and subsequent taxation years.

Subclause 76(2)

ITA
152(4.3) and (4.4)

Subsection 152(4.3) of the Act allows the Minister of National Revenue to reassess beyond the normal reassessment period for a taxation year where it is necessary to do so as a result of an adjustment to an amount deducted or included in computing a "balance" of the taxpayer for another year. The "balance" of a taxpayer for a taxation year is defined in subsection 152(4.4).

This amendment to subsection 152(4.3) limits its application to reassessments of taxation years that follow the year of adjustment, so that the subsection cannot be used for reassessing preceding taxation years. As well, reference is added to allow the Minister to redetermine an amount deemed to have been an overpayment.

The definition of "balance" in subsection 152(4.4) of the Act is also amended to include in that definition any amount deemed to have been an overpayment.

These amendments generally apply to reassessments and redeterminations made after June 10, 1993.

Clause 77

Withholding

ITA
153(1)(m) and (m.1)

Subsection 153(1) of the Act authorizes the withholding of tax from any of the payments described in paragraphs 153(1)(a) to (r). Paragraph 153(1)(m) describes payments under the *Labour Adjustment Benefits Act* and paragraph 153(1)(m.1) describes payments made pursuant to an agreement under section 5 of the *Department of Labour Act.* The person making the payment is required to remit the tax withheld to the Receiver General on behalf of the payee.

This amendment to subsection 153(1) of the Act replaces paragraphs 153(1)(m) and (m.1) with new paragraph 153(1)(m). This amendment is consequential on the amendments to paragraph 56(1)(a) of the Act, which replace subparagraphs 56(1)(a)(vi) and (vii) with new subparagraph 56(1)(a)(vi), under which a prescribed benefit under a government assistance program is included in an individual's income.

The *Income Tax Regulations* will be amended to prescribe those benefits currently described in paragraphs 153(1)(m) and (m.1), as well as income assistance payments under the Plant Workers Adjustment Program and the Northern Cod Compensation and Adjustment Program for purposes of new subparagraph 56(1)(a)(vi) and new paragraph 153(1)(m) of the Act. This recognizes the existing treatment of such benefits, under which persons making these payments are withholding and remitting tax.

New paragraph 153(1)(m) applies to payments made after October 1991, the same time at which the amendments to subparagraphs 56(1)(a)(vi) and(vii) take effect. For further information, reference may be made to the commentary on those subparagraphs.

Clause 78

Election on Emigration

ITA
159(4) and (4.1)

Subsection 159(4) of the Act allows a taxpayer who has ceased to be resident in Canada to pay any tax resulting from the deemed disposition of property under section 48 of the Act in up to six annual instalments, provided the taxpayer gives the Minister of National Revenue adequate security. Subsection 159(4) is replaced by new subsections 159(4) and (4.1), which allow the same privilege with respect to dispositions under new subsection 128.1(4). Because existing section 88.1 excludes the operation of section 48, the election to pay instalments under existing subsection 159(4) is unavailable to most corporations; new subsection 159(4) confirms that the election is available only to individuals.

An election under new subsection 159(4) must be made in prescribed manner on or before the individual's balance-due day for the year in which the individual ceases to be resident in Canada.
Subsection 159(4.1) provides that the first of the resulting instalments is due on that same day, with one instalment due on each subsequent anniversary of that day.

This amendment applies to changes in residence occurring after 1992.

Clause 79

Interest

ITA
161(4.01) and (4.1)

Section 161 of the Act provides that interest is payable by a taxpayer on any outstanding amount of tax payable under Part I for a taxation year, as well as any late or deficient instalments of such tax. Subsection 161(4.01) limits the interest charged where an individual makes tax instalments in accordance with a notice sent for this purpose by the Minister of National Revenue. Subsection 161(4.1) provides that, for the purposes of determining the amount of interest payable by a corporation on late or deficient instalments, the corporation is considered to have been liable to pay instalments calculated by reference to its tax payable under Parts I and VI.1 of the Act for the year, its first instalment base for the year, or a combination of its first and second instalment bases for the year, whichever method gives rise to the least amount of interest charges.

The amendment to subsection 161(4.01) of the Act clarifies that, for individuals, the minimum instalment required to be paid on each due date is the amount that brings the total instalments to date equal to the lowest total amount required to be paid by the individual by that date. Subsection 161(4.1) of the Act is correspondingly amended to clarify that the minimum instalment required to be paid by a corporation on each due date is the amount that is obtained using the one method that gives the lowest total instalments required for the year.

These amendments apply to the 1992 and subsequent taxation years.

Clause 80

Late Filing Penalty for Charities

ITA
162(7)

Subsection 162(7) of the Act provides for penalties for failure to file an information return and for failure to comply with a duty or obligation imposed under the *Income Tax Act* or a regulation. The penalty for such a failure is the greater of $100 and $25 per day of default to a maximum of 100 days ($2,500). The penalty provided for under subsection 162(7) is only to apply in cases where no other penalty is provided for under the *Income Tax Act.*

Subsection 162(7) of the Act is amended to exclude charities that are registered under the Act from the application of this penalty. This amendment, which is effective on Royal Assent, is intended to clarify that, because such charities may be subject to revocation of their registered status and to tax as provided for under Part V of the Act, it is not intended that they also be subject to penalties under this subsection.

Clause 81

Large Corporations Tax – Long-Term Debt

ITA
181(1)

"long-term debt"

Subsection 181(1) of the Act defines certain terms for the purposes of the Part I.3 tax on the capital of large corporations.

The definition "long-term debt" in subsection 181(1) is relevant in determining the capital of financial institutions under Part I.3 and in computing the investment allowance of other corporations. This definition is being amended as a consequence of changes introduced in the new *Bank Act* and *Insurance Companies Act.* The new definition of long-term debt under subsection 181(1) applies as of

June 1, 1992, the date on which the new *Bank Act* and *Insurance Companies Act* were proclaimed in force.

The former *Bank Act* set out a definition of bank debenture that was adopted for the purposes of the long-term debt definition in Part I.3 of the *Income Tax Act*. The new *Bank Act* does not define this term, and this amendment to subsection 181(1) adopts, in its place, the *Bank Act*'s definition of subordinated indebtedness for the purpose of determining the long-term debt of banks as well as other financial institutions that are not insurance companies. The new *Insurance Companies Act* also provides a definition of subordinated indebtedness, and this amendment incorporates that definition for the purpose of applying Part I.3 of the *Income Tax Act* to insurers.

Clause 82

Part I.3 Tax

ITA
181.1(4)(c)

Subsection 181.1(4) of the Act allows a corporation to deduct from its Part I.3 tax payable for a taxation year the amount of its Canadian surtax payable for that year, and any unused surtax credits for the 7 preceding and 3 following taxation years. Paragraph 181.1(4)(c) of the Act is intended to limit this deduction to a corporation's Part I.3 tax otherwise payable, that is, before taking the deduction of Canadian surtax payable into account. However, subsection 181.1(4) incorrectly refers to the tax payable under Part I.3 determined as though section 181.1, which includes the charging or taxing provision of Part I.3, were ignored in its entirety. This amendment, which applies to the 1992 and subsequent taxation years, permits subsection 181.1(4) to operate as intended.

Clause 83

Part I.3 – Financial Institutions

ITA
181.3

Section 181.3 of the Act sets out rules governing the application to financial institutions of the special tax on large corporations imposed under Part I.3.

Subclause 83(1)

ITA
181.3(1)

Subsection 181.3(1) of the Act provides the rules for determining the amount of a financial institution's "taxable capital" – that is, its capital less its allowance for investments in related financial institutions – that is employed in Canada for the purposes of Part I.3. Clause 181.3(1)(c)(ii)(A) applies to life insurance corporations that are resident in Canada and, in its present form, applies to apportion such a corporation's taxable capital on the basis of its Canadian reserve liabilities in relation to its total reserve liabilities.

The amendment to this clause is intended to enable resident life insurance corporations to, in effect, consolidate with their foreign insurance subsidiaries for purposes of Part I.3. Specifically, the amendment provides authority to adopt regulations adding a prescribed amount to an insurer's taxable capital and to its total reserve liabilities. Draft regulations relating to this amendment were released on February 19, 1993. In general terms, the amounts to be prescribed for this purpose are the equity and long-term debt of such foreign subsidiaries (other than that held by the Canadian insurer or by certain other members of its group), and the total reserve liabilities of such subsidiaries.

The amendment to clause 181.3(1)(c)(ii)(A) of the Act applies to taxation years ending after February 25, 1992. Where a corporation has elected to have the amendment to subparagraph 190.11(b)(i) of the Act (described below) apply to its 1991 and subsequent taxation years, this amendment will also apply to the corporation for those years.

Subclauses 83(2), (3) and (4)

ITA
181.3(3)

Subsection 181.3(3) of the Act sets out the rules for calculating the capital of a financial institution for the purposes of Part I.3.

Subparagraph 181.3(3)(c)(iii) applies to resident insurers and includes in capital reserves to the extent that they were not deducted in calculating income under Part I of the Act.
Subparagraph 181.3(3)(d)(iv) applies to non-resident insurers and includes in capital the amount by which the Canadian insurance reserves exceed certain Part I deductions. The Act is amended to include new subparagraph 181.3(3)(c)(vi) and new clause 181.3(3)(d)(iv)(E). The effect of these changes is to reduce the amount of the reserve that is included in the capital of property and casualty insurers by their deferred acquisition expenses that can be considered to form part of that reserve.

Paragraph 181.3(3)(d) also includes in the capital of a non-resident insurer the greater of its surplus funds derived from operations and its attributed surplus for the year in question. "Surplus funds derived from operations" is defined in subsection 138(12) of the Act and, as a result of an amendment to that provision, may depend on the amount of a corporation's liability for the special taxes under Part I.3 (and Part VI) for the year. To avoid the circularity problem that would otherwise arise, the amendment to subparagraph 181.3(3)(d)(i) provides that the amount of the insurer's surplus funds is, insofar as it relates to the computation of an insurer's capital, to be determined without reference to its liability under Part I.3 (and Part VI) for the year.

These amendments apply to taxation years ending after 1991.

Clause 84

Part V – Charities

ITA
188(1) and (2)

Part V of the Act provides that special taxes be paid by charities whose registration under the Act has been revoked, and by persons who engage in certain dealings with registered charities.

Subsection 188(1) of the Act imposes a tax on charities whose registration has been revoked by the Minister of National Revenue. This tax is equal to the total of the value of the assets of the charity on the day notice of the Minister's intention to revoke its registration is mailed plus the amount of receipted donations and intercharity gifts received by the charity after that date. The amount of this tax is reduced by the value of assets transferred to registered charities, amounts expended on charitable activities and amounts used to pay outstanding debts and reasonable expenses.

These amendments to subsection 188(1) of the Act change the date on which the assets of a charity whose registration has been revoked will be valued. Instead of a valuation based on fair market value on the day that the notice of intention to revoke is mailed, assets will be valued at their fair market value on the day that is 120 days before the day that such a notice is mailed. The provisions of subsection 188(1) that deal with the time frames for the calculation of amounts that reduce any revocation tax otherwise payable by a charity are also amended to reflect this new valuation date.

These amendments to subsection 188(1) also clarify that the tax payable by a charity whose registration is revoked is due on the day that is one year after the day that the revocation is effective. At that time, an information return is also to be filed by the charity, whether or not any tax is payable by it under this subsection.

These amendments to subsection 188(1) apply to charities whose registrations are revoked pursuant to notices of intention to revoke their registrations mailed after 1992.

Subsection 188(2) of the Act imposes a tax liability, jointly with a deregistered charity, on persons, other than qualified donees, who receive property from the deregistered charity. These amendments to subsection 188(2) are consequential on the amendments to subsection 188(1) of the Act, which change the date on which such a charity's assets will be valued. Like the amendments to subsection 188(1), these amendments apply with respect to charities whose registrations are revoked pursuant to notices of intention to revoke their registrations mailed after 1992.

Clause 85

Part V – Returns

ITA
189(6)

Subsection 189(6) of the Act requires a taxpayer that is liable for any tax under Part V to file a return, without notice or demand, to estimate the tax due and, except in the case of charities liable to pay a tax on revocation, to pay the tax due. In the case of charities, the Part V return is due at the time that the charity's information return would otherwise be due. For other taxpayers, the Part V return is due at the time the taxpayer's return under Part I is due.

These amendments to subsection 189(6) are consequential on the amendments to subsection 188(1) of the Act that provide that a charity whose registration is revoked must file a return and pay any tax due under that subsection by the day that is one year after the day the revocation is effective. These amendments to subsection 189(6), which apply after 1992, therefore provide that the requirements of subsection 189(6) do not apply in the case of charities that are liable to pay tax under subsection 188(1).

Clause 86

Part VI Tax on the Capital of Financial Institutions

ITA
190(1)

Subsection 190(1) of the Act defines certain terms for the purposes of the Part VI tax on the capital of financial institutions.

The definition "long-term debt" in subsection 190(1) is relevant in determining the capital of financial institutions under Part VI and in computing the investment allowance of other financial institutions. This definition is being amended as a consequence of changes introduced in the new *Bank Act* and *Insurance Companies Act.* The new definition of long-term debt under subsection 190(1) applies as of June 1, 1992, the date on which the new *Bank Act* and *Insurance Companies Act* were proclaimed in force.

The former *Bank Act* set out a definition of "bank debenture" that was adopted for the purposes of the long-term debt definition in Part VI of the *Income Tax Act.* The new *Bank Act* does not define this term, and this amendment to subsection 190(1) adopts, in its place, the *Bank Act*'s definition of subordinated indebtedness for the purpose of determining the long-term debt of banks as well as other financial institutions that are not insurance companies. The new *Insurance Companies Act* also provides a definition of subordinated indebtedness, and this amendment incorporates that definition for the purpose of applying Part VI of the *Income Tax Act* to insurers.

Subsection 190 of the Act is also amended for the 1992 and subsequent taxation years to incorporate the definition of reserves currently found in Part I.3 of the Act, and to adopt – in subsection 190(2) – certain rules of interpretation that have applied under Part I.3 since its introduction in 1989. These amendments are not intended to affect any calculations required under Part VI, and are being made simply to confirm that, with respect to the matters they affect, Part I.3 and VI are to be interpreted in a consistent manner.

Clause 87

Part VI Tax – Life Insurers

ITA
190.1(1.1)

New subsection 190(1.1) of the Act imposes an additional temporary Part VI tax on the capital employed in Canada for a taxation year of life insurers in excess of their "capital allowance". The additional amount of Part VI tax will be levied on the basis of the following ranges of taxable capital employed in Canada for the year:

	Temporary Tax	Existing Tax	Total Part VI Tax
$10-50 million:	0.5%	-	0.5%
$50-100 million:	0.75%	-	0.75%
$100-200 million:	1.0%	-	1.0%
$200-300 million:	0.5%	1.00%	1.5%
over $300 million:	0.25%	1.25%	1.5%

It may be noted that new subsection 190.1(1.1) contains only a single rate of 1%: the lesser rates imposed under four of the five ranges of taxable capital employed in Canada are achieved by excluding varying proportions of taxable capital in these ranges through the capital allowance. (For example, the 0.75% rate imposed on taxable capital between $50 and $100 million is realized by deducting 1/4 of the corporation's taxable capital within that range.)

The terms "taxable capital employed in Canada" and "capital allowance" are defined in sections 190.11 and 190.16, respectively. New subsection 190(1.1) applies to taxation years ending after February 25, 1992 and commencing before 1996, and is subject to pro-ration for short taxation years and for taxation years beginning before February 26, 1992 or ending after 1995. The additional tax will also apply to the taxation years of a life insurance corporation ending after 1990 and before February 26, 1992, where the corporation has elected to have the amendments set out in paragraph 190.11(b) of the Act apply to its 1991 and subsequent years.

The situation may arise where a life insurance company has not elected to pay the additional tax under subsection 190.1(1.1) for its 1991 taxation year, but has elected, under an earlier amendment to Part VI, to have the system of crediting Part I tax against Part VI apply with respect to that year. A transitional provision applies in such case to prevent the deduction of Part I tax payable by the company for its 1991 year against the additional tax payable under Part VI for 1992 and subsequent years.

Clause 88

Taxable Capital Employed in Canada

ITA
190.11(b)(i)

Section 190.11 of the Act provides the rules for determining the amount of a financial institution's "taxable capital" – that is, its capital less its allowance for investments in related financial institutions – that is employed in Canada for the purposes of Part VI. Subparagraph 190.11(b)(i) applies to life insurance corporations that are resident in Canada and, in its present form, applies to apportion such a corporation's taxable capital on the basis of its Canadian reserve liabilities in relation to its total reserve liabilities.

The amendment to this subparagraph is intended to enable resident life insurance corporations to, in effect, consolidate with their foreign insurance subsidiaries for purposes of Part VI. Specifically, the amendment provides authority to adopt regulations adding a prescribed amount to an insurer's taxable capital and to its total reserve liabilities. Draft regulations relating to this amendment were released on February 19, 1993. In general terms, the amounts to be prescribed for this purpose are the equity and long-term debt of such foreign subsidiaries (other than that held by the Canadian insurer or by certain other members of its group), and the total reserve liabilities of such subsidiaries.

The amendment to subparagraph 190.11(b)(i) of the Act applies to taxation years ending after February 25, 1992, although a corporation may elect to have the amendment apply to its 1991 and subsequent taxation years ending after 1990 and before February 26, 1992.

Clause 89

Rules in Computing Part VI Tax

ITA
190.13

Section 190.13 of the Act sets out the rules for calculating the capital of a financial institution for the purposes of Part VI.

Subclauses 89(1), (2), (3) and (4)

ITA
190.13(a) and (b)

These amendments to paragraphs 190.13(a) and (b) of the Act are strictly consequential on the amendment to subsection 190(2) of the Act, which, in adopting subsection 181(2) of the Act for the purposes of Part VI, provides that the consolidation method of accounting is not to be used and applies the term "carrying value" for the purposes of determining investments in related financial institutions. Accordingly, the prohibition against the consolidation method of accounting is deleted from these paragraphs.

Subparagraph 190.13(a)(iii) is also amended to delete the inclusion of deferred taxes as part of a corporation's reserves. This reference had been made only for greater certainty and is rendered superfluous by the new definition of reserves in subsection 190(1) of the Act.

These amendments apply to the 1992 and subsequent taxation years.

Subclause 89(5)

ITA
190.13(c)

Paragraph 190.13(c) of the Act applies to non-resident insurance corporations, and includes in such an institution's capital the greater of its surplus funds derived from operations and its attributed surplus for the year in question. "Surplus funds derived from operations" is defined in subsection 138(12) of the Act and, as a result of an amendment to that provision, may depend on the amount of a corporation's liability under Part VI (and Part I.3). To avoid the circularity problem that would otherwise arise, the amendment to subparagraph 190.13(c)(i) provides that the amount of the insurer's surplus funds is, insofar as it relates to the computation of an insurer's capital, to be determined without reference to its liability under Part VI (and Part I.3) for the year.

Paragraph 190.13(c) is also amended to delete the prohibition against the consolidation method of accounting. For further information on this point, reference may be made to the commentary in these notes on the amendments to paragraphs 190.13(a) and (b).

These amendments apply to the 1992 and subsequent taxation years.

Clause 90

Part VI Tax – Investments in Related Institutions

ITA
190.14

Section 190.14 provides rules to measure a financial institution's investments in related institutions for the purposes of Part VI of the Act. These amendments to subparagraph 190.14(a)(i) are strictly consequential on the amendment to subsection 190(2) of the Act, which, in adopting subsection 181(2) of the Act for the purposes of Part VI, provides that the consolidation method of accounting is not to be used and applies the term "carrying value" for the purposes of determining investments in related financial institutions. Accordingly, the prohibition against the consolidation method is deleted from subparagraph 190.14(a)(i), and the term "cost" is replaced with the term "carrying value".

These amendments apply to the 1992 and subsequent taxation years.

Clause 91

Part VI Tax – Capital Allowance

ITA
190.16

New section 190.16 of the Act contains the rules for determining the amount of a corporation's capital allowance for the purposes of the additional temporary Part VI tax on life insurance corporations. Under subsection 190.16(1) a corporation's capital allowance for a taxation year is, unless the corporation was related to another life insurance corporation at the end of the year, the total of:

(a) $10 million,

(b) 1/2 of its taxable capital between $10 and $50 million,

(c) 1/4 of its taxable capital between $50 and $100 million,

(d) 1/2 of its taxable capital between $200 and $300 million, and

(e) 3/4 of its taxable capital in excess of $300 million.

The exclusion, through the capital allowance, of varying proportions of a corporation's taxable capital in excess of $10 million serves to create the effective rates of tax set out in the commentary to new subsection 190.1(1.1) of the Act.

Where a life insurance corporation is related to one or more other life insurers, all of the related life insurance corporations must share the capital allowance. Under new subsection 190.16(2) related corporations may file with the Minister of National Revenue an agreement in prescribed form on behalf of the related group allocating among them the capital allowance described above. If such an agreement is not filed the Minister may, pursuant to subsection 190.16(3), make such an allocation among the related institutions. Where related life insurance corporations fail to file an agreement and the Minister makes no allocation for them, subsection 190.16(4) provides that no capital allowance is available to the members of the related group for the taxation year in question.

New section 190.16 of the Act applies to taxation years ending after February 25, 1992. Where a corporation has elected to have the amendment to paragraph 190.11(b) of the Act apply to its 1991 and subsequent taxation years, the additional tax under new subsection 190.1(1.1) as well as new section 190.16 – which relates to the application of that tax – will also apply to the corporation for those years.

Clause 92

RRSPs – Cumulative Excess Amount

ITA
204.2(1.2)

Subsection 204.1(2.1) of the Act provides a penalty tax on an individual who has made excess RRSP contributions. This tax is determined with reference to the individual's "cumulative excess amount". Subsections 204.2(1.1) to (1.4) set out the method for determining an individual's cumulative excess amount.

Subsection 204.2(1.2) is amended so that RRSP contributions by way of a transfer from a prescribed provincial pension plan in circumstances to which new subsection 146(21) applies are not included in determining an individual's cumulative excess amount.

This amendment applies to the 1992 and subsequent taxation years.

Clause 93

Foreign Property Tax

ITA
206

Part XI of the Act imposes a tax on the amount of foreign property, in excess of defined limits, held by pension funds and certain other tax-exempt entities.

Subclause 93(1)

ITA
206(1)

"foreign property"

The definition of "foreign property" in subsection 206(1) of the Act is amended to clarify that all forms of indebtedness of a non-resident person owed to a tax-exempt entity constitute "foreign property" for the purposes of Part XI of the Act.

This amendment applies to months after 1992.

Subclause 93(2)

ITA
206(2.1)

Under the existing law, tax is payable under subsection 206(2) of the Act by tax-exempt taxpayers referred to in section 205 with respect to their foreign property holdings in excess of a defined limit. These taxpayers include a "master trust" referred to in paragraph 149(1)(o.4) and corporations described in paragraph 149(1)(o.2) (i.e., generally certain types of corporations involved with pension fund administration the shares of which are held by registered pension plans). However, where a master trust has made an election for the "look-through" rules in section 259 of the Act to apply to its beneficiaries for a period, subsection 206(2.1) provides that no tax is payable by the trust under subsection 206(2) for the period.

Subsection 206(2.1) is amended so that likewise no tax is payable under subsection 206(2) by a corporation described in paragraph 149(1)(o.2) in respect of a period for which the corporation makes an election that the look-through rules in section 259 apply to its shareholders. This amendment is strictly consequential on the introduction of new subsection 259(2) under which these look-through rules are extended to such corporations.

This amendment applies to the 1992 and subsequent taxation years.

Clause 94

RCA Rules

ITA
207.6(5)

Paragraph (l) of the definition of "retirement compensation arrangement" (RCA) in subsection 248(1) of the Act excludes from that definition a retirement plan (other than an athlete's plan) maintained primarily for the benefit of non-residents in respect of services rendered outside Canada. However, special rules in subsection 207.6(5) of the Act apply where contributions are made to a foreign plan of this type in respect of employees resident in Canada. The foreign plan, as it applies with respect to such contributions, is considered to be an RCA. Thus, such contributions, and any investment income derived therefrom, are subject to the refundable RCA tax. As an exception, these rules do not apply to contributions made in respect of an employee who has been resident in Canada for less than five years if the employee was a member of the foreign plan before becoming a Canadian resident.

Subsection 207.6(5) is amended to replace the description of the contributions to which it applies by a reference to "resident's contributions". This expression is defined in new subsection 207.6(5.1). The change is made as a consequence of amendments to the conditions for determining which contributions made to a foreign plan are subject to the rules in subsection 207.6(5).

Subsection 207.6(5) is also amended to clarify that only one RCA is considered to exist in respect of a foreign plan, regardless of the number of Canadian resident employees who participate in the plan and the number of contributions made to the plan in respect of those employees. This is relevant for compliance with the administrative requirements applicable to RCAs.

The amendments to subsection 207.6(5) are applicable after October 8, 1986.

ITA
207.6(5.1)

New subsection 207.6(5.1) of the Act defines the expression "resident's contribution" for the purpose of subsection 207.6(5), which applies the RCA rules to such contributions. The definition applies to contributions made to a foreign retirement plan that is excluded from being an RCA by paragraph (l) of the definition of RCA. Such a contribution is a resident's contribution to the extent that (i) it is made in respect of services rendered by a Canadian resident employee that were primarily services rendered in Canada or services rendered in connection with a business carried on by the employer in Canada (or a combination of such services), and (ii) it is not a prescribed contribution. Contributions made in respect of an employee who has been resident in Canada for less than five of the preceding six years are excluded if the employee was a member of the foreign plan before becoming a Canadian resident, or became a plan member by the end of the calendar month following the month in which the employee became a resident. For the purpose of determining when an employee became a member of a foreign plan, if the employee's benefits under one plan have been replaced by benefits under another plan, the replacement plan is considered to be the same plan as the first plan.

This definition of "resident's contribution" does not include certain contributions that were included in the description of contributions contained in subsection 207.6(5):

- It does not include contributions made on behalf of an individual who renders services outside Canada where those services do not relate to a business of the employer in Canada. For example, if a Canadian resident works in the U.S. for an employer who does not carry on business in Canada, contributions made by the U.S. employer to the company pension plan in respect of the individual will not be considered to be resident's contributions. However, the RRSP room of such an individual will be reduced by virtue of the new rules in proposed section 8308.2 of the *Income Tax Regulations* released by the Minister of Finance on December 18, 1992.

- "Resident's contributions" do not include contributions prescribed by regulation. Proposed section 6804 of the Regulations prescribes contributions for this purpose. In general terms, contributions made after 1991 to a foreign plan are prescribed where they are made in respect of the employees of an employer who has elected to report pension adjustments in connection with the participation of the employees in the foreign plan and certain other conditions are satisfied. For further information, see the commentary on proposed section 6804 (released by the Minister of Finance on December 18, 1992).

- Contributions made during the first five years of residence in Canada are excluded where an individual became a member of the foreign plan shortly after becoming a Canadian resident.

- Where an individual's benefits under a foreign plan are replaced by benefits under another foreign plan after the individual becomes a Canadian resident, contributions made to the replacement plan during the first five years of residence are excluded if contributions to the initial plan were excluded.

It should be noted that resident's contributions may include, in addition to contributions made by an employer in respect of its employees, contributions made by anyone else (including the employees) in respect of those employees. For example, contributions made to a foreign plan by a foreign parent corporation in respect of employees of its Canadian subsidiary may be resident's contributions.

New subsection 207.6(5.1) applies after October 8, 1986.

Clause 95

Carved-Out Property

ITA
209(2)

Subsection 209(2) of the Act imposes a special tax on a person for a taxation year equal to 50% of the person's "carved-out income" for the year from "carved-out properties". The purpose of this tax is to discourage the use of tax-exempt persons and loss corporations in holding profitable resource property in respect of which a profitable taxpayer retains a substantial economic interest. The 50% rate approximated the maximum combined federal/provincial corporate income tax rate at the time the special tax was introduced.

Subsection 209(2) is amended to reduce the 50% rate to 45%, which approximates the maximum combined federal/provincial corporate income tax rate at the present time. The purpose of this amendment, in conjunction with existing subsection 66(14.6) which provides a taxpayer with a deduction in computing income with respect to the taxpayer's carved-out income, is to allow profitable corporations the opportunity to hold carved-out property on a tax-neutral basis.

This amendment applies to the 1992 and subsequent taxation years.

Clause 96

Part XII.2 Tax – Trusts

ITA
210(d)

Part XII.2 of the Act provides for a tax on certain trusts with respect to distributions of Canadian-source income. The tax is fully refundable to the extent paid to beneficiaries who are not "designated beneficiaries". A designated beneficiary under a trust is a beneficiary not resident in Canada, but in some cases includes other beneficiaries.

The definition "designated beneficiary" in section 210 is amended so that a mutual fund trust is excluded as a "designated beneficiary" under another trust, regardless of the nature of the mutual fund trust's beneficiaries. This is consistent with the exemption from the payment of Part XII.2 tax provided for mutual fund trusts.

This amendment applies to the 1993 and subsequent taxation years.

Clause 97

Non-Resident Withholding Tax

ITA
212

Section 212 of the Act imposes a tax of 25 per cent (reduced by many treaties) on certain amounts paid or credited to non-residents by residents of Canada.

Subclause 97(1)

ITA
212(1)(b)(xii)

Listed in paragraph 212(1)(b) of the Act are a number of exceptions to the requirement that a 25% tax (often reduced by treaty) be withheld and remitted on interest paid or credited to a non-resident person by a person resident in Canada. New subparagraph 212(1)(b)(xii) provides an exemption from this tax for interest payable under certain securities lending arrangements by a securities lender that is a member of the Canadian Payments Association, or is a registered or licensed securities trader resident in Canada, if the interest is payable on money provided to the lender as collateral or consideration for the securities transferred under the arrangement.

In order to benefit from the exemption, the securities transferred under the arrangement must be obligations described in subparagraph 212(1)(b)(ii) of the Act, such as federal or provincial government bonds, or debt obligations of a foreign government. In addition, the collateral or consideration in respect of which the interest is payable may not exceed 110% of the fair market value of the securities transferred at any time during the arrangement. The exemption is limited to securities lending arrangements with a term not exceeding 270 days and is not available if the arrangement is part of a series of securities lending arrangements, loans or other transactions intended to provide money to the lender for more than 270 days.

New subparagraph 212(1)(b)(xii) applies to securities lending arrangements entered into after May 28, 1993.

Subclauses 97(2) and (3)

ITA
212(1)(h)

Paragraph 212(1)(h) of the Act provides for withholding tax in respect of the payment of pension benefits to non-residents, including pension benefits paid from prescribed provincial pension plans (i.e. the Saskatchewan Pension Plan). This provision is amended so that lump sum transfers made, pursuant to an authorization in prescribed form in circumstances to which new subsection 146(21) applies, are exempted from the application of withholding tax.

This amendment applies to payments made after August 1992.

Subclause 97(4)

ITA
212(3)

Subparagraph 212(1)(b)(vii) of the Act provides an exemption from non-resident withholding tax for interest paid to arm's length parties on what is commonly known as "long-term" corporate debt - that is, debt not more than 25% of the principal amount of which is payable within 5 years of the date of issue, other than in certain special situations. New subsection 212(3) of the Act provides that for the purposes of the subparagraph 212(1)(b)(vii) exemption, a debt obligation issued by a corporation in financial difficulty to replace an obligation qualifying for the exemption will be treated as having been issued at the same time as the former obligation. A corporation restructuring its long-term debt may, as a result, be able to ensure that the fact of having refinanced an existing obligation does not by itself cause Part XIII tax to be imposed.

For new subsection 212(3) to apply, three conditions must be met. First, the obligation in question (the "replacement obligation") must have been issued in exchange or substitution for another obligation (the "former obligation") on which interest was (or would be, if the creditor were a non-resident) exempt under subparagraph 212(1)(b)(vii). Second, the replacement obligation must have been issued in circumstances of financial difficulty generally comparable to those described in paragraph (e) of the "term preferred share" definition in subsection 248(1) of the Act. In particular, the replacement obligation must be issued

- as part of a court-approved proposal or arrangement under the *Bankruptcy and Insolvency Act*;
- at a time when the issuer's assets are under the control of a receiver or the equivalent; or
- at a time when financial difficulty has caused or could reasonably be expected to cause the issuer (or another, non-arm's length corporation resident in Canada) to default on the former obligation.

The last condition is that all proceeds from the issuance of the replacement obligation must be used, either by the issuing corporation or another with which it does not deal at arm's length, to finance an active business it carried on in Canada immediately before the replacement obligation was issued.

Where these requirements are met, new subsection 212(3) deems the replacement obligation to have been issued when the former obligation was issued for the purposes of the 5-year test in subparagraph 212(1)(b)(vii).

This amendment applies to replacement obligations issued after June 1993.

Subclause 97(5)

ITA
212(18)

Subsection 212(18) of the Act provides that financial institutions prescribed for the purpose of clause 212(1)(b)(iii)(D) – the exemption from non-resident withholding tax on interest paid on foreign currency deposits – are required to file annual information returns and, where requested, an undertaking relating to avoidance of tax under Part XIII of the Act. The requirement to file an annual information return is extended to such institutions, as well as securities dealers, that pay or credit interest to a non-resident person that is exempt from Part XIII tax because of new subparagraph 212(1)(b)(xii).

The amendment to subsection 212(18) applies to taxation years ending after May 28, 1993.

Subclause 97(6)

ITA
212(19)

New subsection 212(19) of the Act is introduced as a consequence of the exemption provided under new subparagraph 212(1)(b)(xii) for interest payments made by securities dealers to non-residents under certain securities lending arrangements. While the amount of that exemption is unlimited, new subsection 212(19) imposes a tax on the securities dealer if amounts borrowed by the dealer that generate such payments exceed certain limits. Where that occurs, a 25 per cent tax is levied on interest on the excess calculated at a prescribed rate. This rate is prescribed under the *Income Tax Regulations*.

The tax imposed by new subsection 212(19) is to be computed on a daily basis and is equal to 1/365 of 25% of the prescribed rate in effect for the relevant day, multiplied by the amount by which the total determined for "A" in the formula exceeds that determined for "B". The amount determined for "A" is the total amount of money provided to the dealer by a non-resident person as collateral or consideration for securities lent or transferred to the non-resident under a securities lending arrangement to which the non-resident withholding tax exemption in new subparagraph 212(1)(b)(xii) applies (generally, government debt obligations) to the extent that the money has not been returned or repaid by the end of the relevant day. The amount determined for "B" is the total of two figures: the first is the amount of money provided by the dealer to a non-resident person (and not returned or repaid to the dealer by the end of the relevant day) as collateral or consideration for government debt obligations acquired by the dealer under a securities lending arrangement; and the second is the greater of 10 times the amount of capital employed by the dealer and 20 times the amount of capital required to be maintained by the dealer as a margin in respect of securities described in clause 212(1)(b)(xii)(A) (determined at the end of the relevant day in accordance with the laws of one or more provinces under which the trader is registered or licensed).

The tax payable under subsection 212(19) is to be remitted by the 15th day of the month following the month in which the relevant day occurs.

New subsection 212(19) applies to securities lending arrangements entered into after May 28, 1993.

Clause 98

Deemed Payments – Non-Residents

ITA
214(3)(c) and (i)

Under subsections 214(3) and (3.1) of the Act, certain amounts are treated, for the purposes of the non-resident withholding tax, as payments to a non-resident person. Paragraph 214(3)(c) applies to amounts that are deemed by section 146 and subsection 146.3(6.1) of the Act to be received from an RRSP. Paragraph 214(3)(i) deals with amounts that are deemed by section 146.3 to be received from a RRIF.

Subsection 214(3) is amended to delete the reference in paragraph 214(3)(c) to subsection 146.3(6.1) and add that reference to paragraph 214(3)(i). This is strictly consequential on the amendments to subsection 146.3(6.1) which treat RRIF distributions as having been received under a RRIF rather than an RRSP.

This amendment applies to payments made after 1992.

Clause 99

Corporate Emigration

ITA
219.1

Section 219.1 of the Act imposes a tax under Part XIV of the Act where a corporation's taxation year is deemed by section 88.1 of the Act to have ended, that is, where a corporation either has been continued abroad or is treated as a non-resident by virtue of having become resident in a country whose tax treaty with Canada provides that result. This tax is computed as 25% of the amount, if any, by which the corporation's deemed proceeds of disposition on emigration exceed the total immediately before the end of the year of the paid-up capital of all its shares and all of the corporation's debts and obligations (other than dividend amounts payable).

Section 219.1 is amended, as part of a set of amendments concerning taxpayers' residence and certain related matters, to delete the reference to the year-end deemed by section 88.1 of the Act, which is repealed. Instead, section 219.1 will apply whenever a corporation ceases to be a Canadian corporation. Such a change of status can result either from continuing outside Canada or from ceasing to be resident here. In addition, the reference in section 219.1 to the proceeds of disposition deemed to have been received by the corporation is replaced by a reference to the total fair market value of all of the corporation's property. This ensures the correct calculation of the tax in cases where there has been no deemed disposition (as, for example, where a corporation continues abroad but remains resident in Canada). Finally, section 219.1 is amended to confirm that tax payable otherwise than under section 219.1 is not itself included in the amount subject to the tax.

These amendments generally apply after 1992, although they may also apply before that time to corporations electing to be subject to new subsection 250(5.1) of the Act. For further information, reference may be made to the commentary on that provision.

Clause 100

Limitation of Branch Tax on Corporate Emigration

ITA
219.2

Where a tax treaty between Canada and another country limits the rate of withholding tax imposed under Part XIII on dividends paid by a corporation resident in Canada to a resident of the other country, but does not limit the rate of tax levied under Part XIV on repatriated branch earnings of corporations resident in the other country, section 219.2 of the Act reduces the rate of tax that is imposed under Part XIV. Section 219.2 is amended to provide that, in the above situation, the rate of tax under Part XIV will be reduced to the Part XIII rate which, under the treaty, would apply to a dividend paid by a corporation resident in Canada to a non-resident corporation that owns all of the shares of the resident corporation. As well, consequential on the introduction of new section 219.3 of the Act, section 219.2 is amended to clarify that it applies only with respect to amounts levied under section 219, and not in respect of amounts levied under section 219.1. These amendments to section 219.2 apply to the 1985 and subsequent taxation years.

ITA
219.3

New section 219.3 of the Act provides that where a corporation emigrates to a country that has a tax treaty with Canada and the rate of Part XIII tax on dividends under that treaty is less than 25%, then the tax payable by the corporation under section 219.1 will be reduced to the Part XIII rate which, under the treaty, would apply to a dividend paid by a corporation resident in Canada to a non-resident corporation that owns all the shares of the resident corporation. This new section applies to the 1985 and subsequent taxation years, except that for taxation years ending after June 1993, it will apply only where it cannot reasonably be considered that one of the main reasons for the corporation becoming resident in the other country was to reduce the amount of tax payable under Parts XIII and XIV.

Clause 101

Garnishment Rules

ITA
224

Subsections 224(1) and (1.1) contain the principal garnishment provisions under the Act. These provisions empower the Minister of National Revenue to collect unpaid taxes and other amounts owing under the Act by a person (the "tax debtor") by serving a garnishment letter on any person liable to make a payment to the tax debtor or on a financial institution or certain other persons intending to loan or advance money to the tax debtor. The garnishment letter requires these amounts to be paid to the Receiver General rather than to the tax debtor.

Subsection 224(1.2) of the Act provides the Minister of National Revenue with an enhanced garnishment power to intercept payments that are owed to a tax debtor or to a secured creditor of the tax debtor who has a security interest such as an assignment of trade receivables. Upon receipt of an enhanced garnishment letter by a person who owes money to another person who has failed to remit source deductions, the garnished amount becomes the property of Her Majesty and must be paid to the Receiver General in priority over any security interest in that money.

Subsection 224(3) of the Act provides for the garnishment of periodic payments such as interest, rent, remuneration, dividends or annuity payments. In the case of such periodic payments, notice served upon the garnishee regarding the taxpayer's liability under the Act automatically effects a continuing garnishment applicable against future payments to be made by the garnishee until the full liability of the taxpayer is satisfied. The garnishee must make payment to the Receiver General out of each payment in the amount specified in the Minister's notice.

The amendments in subclauses 101(1) and (3) provide that garnishment orders issued after Royal Assent under subsections 224(1) and (1.2) of the Act will be effective for one year rather than 90 days. The amendments in subclause 101(1), along with the amendments in subclauses 101(2), (4) and (6), also replace the requirement in subsections 224(1), (1.1), (1.2) and (3) of the Act that the Minister use registered mail for garnishment procedures with a requirement that the Minister institute such an action in writing, beginning in 1993.

New subsection 224(1.4) is added to the Act by subclause 101(5) to ensure that both the federal and provincial Crown are bound by garnishment letters sent by the Minister of National Revenue. This new subsection is effective on Royal Assent.

Subsections 224(5) and (6) of the Act provide that garnishment requirements under subsection 224(1) or (1.2) may be addressed to the name under which a business is carried on or to the name of a partnership. The amendments in subclauses 101(7) extend these procedural rules to apply to garnishments effected under subsection 224(1.1) and also remove the references therein to service by registered mail. These amendments apply after 1992.

Clause 102

Payments of Moneys Seized From Tax Debtor

ITA
224.3(1)

Subsection 224.3(1) of the Act enables the Minister of National Revenue to issue a garnishment order in cases where moneys have been seized from a taxpayer by the police in the course of administering or enforcing the criminal law of Canada under circumstances where the moneys may be restored to the taxpayer. Such an order could not technically be made in the absence of this provision due to the absence of a debtor-creditor relationship between the police and the taxpayer. This subsection is amended, applicable to garnishment requests made after 1992, to remove the requirement that the Minister use registered mail for garnishment purposes.

Clause 103

Collection Restrictions

ITA
225.1(8)

Subsection 225.1(8) of the Act defines "large corporation" for the purposes of the rules governing the collection and repayment of amounts in controversy. This amendment makes two minor modifications to that definition. First, the intended reference in paragraph 225.1(8)(a) to the crediting of corporate surtax against Part I.3 tax is amended to cite the correct provision. Second, paragraph 225.1(8)(b) is amended to clarify that in determining whether a corporation is related to a large corporation, the test of relatedness in section 181.5 of the Act is applied as that section reads in its application to the 1992 taxation year. These changes apply after Royal Assent.

Clause 104

Repayment of Non-Resident Shareholder Loans

ITA
227

Section 227 of the Act provides special rules relating to source deductions and non-resident withholding tax under sections 153 and 215, respectively, and also deals with the application of certain Parts of the Act to particular persons and entities.

Subclause 104(1)

ITA
227(4) and (5)

Subsection 227(4) of the Act provides that amounts withheld from payments made by a payer in respect of taxes payable by the recipient are deemed to be held in trust for her Majesty.
Subsection 227(4) is amended, effective on Royal Assent, to clarify

that the deemed trust arising in respect of taxes withheld is impressed on the funds at the time the amounts are withheld.

Subsection 227(5) of the Act provides that, in the event of the liquidation, assignment, receivership or bankruptcy of or by a person, such amounts, as well as similar amounts deemed to be held in trust for her Majesty under the laws of a province with which the federal government has a tax collection agreement, will not form part of the estate of that person, notwithstanding the provisions of the *Bankruptcy Act.* This subsection is repealed, effective on Royal Assent, as amendments to the *Bankruptcy Act* have made these provisions redundant.

ITA
227(6)

Subsection 227(6) of the Act provides for a refund, upon application, of Part XIII tax paid to the Receiver General on behalf of a non-resident person where the non-resident was not liable to pay that tax or where the amount paid exceeded the amount that the non-resident was liable to pay. Subsection 227(6) also allows the Minister to apply the amount of that refund to any payment that the non-resident person is liable, or is about to become liable, to pay under the *Income Tax Act.*

Subsection 227(6) is amended, applicable on Royal Assent, to authorize the Minister to apply the amount of that refund to any other amount that is owed, or is about to become owed, by the non-resident person to Her Majesty in right of Canada, and also to ensure that the subsection applies to amounts paid to the Receiver General by or on behalf of a non-resident regardless of whether those amounts were deducted or withheld.

ITA
227(6.1)

Loans made by a corporation, or by a partnership of which the corporation is a member, to a shareholder who is a resident of Canada may be included in the shareholder's income by reason of subsection 15(2) of the Act. When the loan is subsequently repaid, the shareholder may be entitled to a deduction under paragraph 20(1)(j) of the Act for the amount that had previously been included in the shareholder's income. Where the shareholder is not a resident of Canada, paragraph 214(3)(a) of the Act provides that the amount of any such loan that would have been included in the shareholder's income if Part I of the Act applied is to be treated as a dividend for the purposes of Part XIII. Non-resident withholding tax will therefore be exigible on that amount. There is no provision in Part XIII, however, that provides for tax relief on repayment of the loan.

New subsection 227(6.1) of the Act provides for a refund of Part XIII tax paid when that loan or indebtedness is repaid. In order to obtain the refund, it will be necessary to establish, by subsequent events or otherwise, that the repayment was not made as part of a series of loans or other transactions and repayments. Where only a portion of the loan has been repaid, the amount of the refund will be based on the tax that was paid on that portion of the loan or indebtedness. The refund is limited to the lesser of the tax originally paid in respect of the amount repaid and the Part XIII tax that would be payable at the time of the repayment if a dividend equal to that amount were paid to the non-resident at that time.

In order to obtain the refund, written application must be made to the Minister of National Revenue within 2 years after the end of the calendar year in which the repayment is made. Where the non-resident person is otherwise liable, or about to become liable, to make a payment to Her Majesty in Right of Canada, new subsection 227(6.1) permits the Minister to apply the amount of the refund to that payment and requires that the non-resident be notified of that action. This latter provision is identical to that of amended subsection 227(6) of the Act, which deals with refunds of overpayments of Part XIII tax.

New subsection 227(6.1) of the Act applies to repayments made after December 21, 1992.

ITA
227(7)

Subsection 227(7) of the Act requires the Minister of National Revenue to assess a person who applies under subsection 227(6) for a refund of Part XIII tax if the Minister is not satisfied that the person was not liable to pay all or part of the tax. The subsection also incorporates by reference the objection and appeal procedures set out in Divisions I and J of Part I of the Act.

Subsection 227(7) is amended, applicable on Royal Assent, to ensure that it applies to amounts paid to the Receiver General by or on behalf of a non-resident regardless of whether those amounts were deducted or withheld.

ITA
227(7.1)

New subsection 227(7.1) of the Act provides that where the Minister of National Revenue is not satisfied that a person is entitled to an amount claimed under subsection 227(6.1), the Minister is required, upon request, to determine the amount payable under that subsection and send a notice of determination to that person. Division I (relating to returns, assessments, payments and appeals) and Division J (relating to appeals to the Tax Court of Canada and the Federal Court) of Part I of the Act will apply with such modifications as are necessary to enable the person to object to the determination and take advantage of the appeal procedures set out in the Act. The exception for subsections 164(1.1) to (1.31) of the Act ensures that where a non-resident objects to or appeals from the determination, Part XIII tax need not be repaid by Revenue Canada until such time as a final decision has been made on the matter.

New subsection 227(7.1) of the Act applies to repayments made after December 21, 1992.

Subclause 104(2)

ITA
227(9.3)

Subsection 227(9.3) of the Act provides that interest at the prescribed rate is to be paid on certain taxes not paid on a timely basis. This subsection, which applies to taxes payable because of section 116 of the Act or a regulation made under subsection 215(4) of the Act, will also apply, after May 28, 1993, to taxes arising under new subsection 212(19) of the Act.

Subclause 104(3)

ITA
227(10)(a.1)

Subsection 227(10) of the Act empowers the Minister of National Revenue to assess a person for various amounts, including penalties and other amounts payable by that person in respect of a failure to comply with obligations to withhold. The amendment adds, in new paragraph 227(10)(a.1), the right to assess a person for any amount payable by that person under new subsection 227(10.2) where the amount is payable as a consequence of a failure by a non-resident person to withhold tax from a contribution to a retirement compensation arrangement. This amendment is applicable on Royal Assent.

Subclause 104(4)

ITA
227(10.1)

Subsection 227(10.1) of the Act empowers the Minister of National Revenue to assess a person for various amounts, including penalties and other amounts payable by that person in respect of a failure to remit an amount that was withheld as required by the Act. Two amendments are being made to this subsection.

First, subsection 227(10.1) is amended to provide that the Minister may also assess a person in respect of an amount payable under section 116 of the Act. Section 116 contains procedures for collecting tax from non-resident persons on the disposition of particular types of taxable Canadian properties and Canadian resource properties. This amendment applies to amounts that become payable after 1990.

Second, new paragraph 227(10.1)(a.1) adds the right to assess a person for any amount payable by that person under new subsection 227(10.2) where the amount is payable as a consequence of a failure by a non-resident person to remit tax that was withheld from a contribution to a retirement compensation arrangement. This amendment is applicable on Royal Assent.

Subclause 104(5)

ITA
227(10.2)

A person who has failed to withhold tax from a contribution to a retirement compensation arrangement (RCA) is liable to a penalty under subsection 227(8) of the Act and is required by subsection 227(8.3) to pay interest on the tax that was not withheld. In addition, the person is liable under subsection 227(8.2) to pay to Her Majesty an amount equal to the contribution. A person who withholds tax from an RCA contribution but does not remit the tax is liable to a penalty under subsection 227(9), is required by subsection 227(9.2) to pay interest on the amount withheld, and is required by subsection 227(9.4) to pay as tax the amount withheld.

New subsection 227(10.2) provides that where the person who has failed to withhold or remit is a non-resident and the contribution was made on behalf of employees or former employees of an employer with whom the non-resident does not deal at arm's length, the employer is jointly and severally liable with the non-resident to pay any amounts that are payable under subsections 227(8), (8.2), (8.3), (9), (9.2) and (9.4). This rule would apply, for example, where a foreign parent corporation makes contributions to a foreign pension plan in respect of the Canadian resident employees of its Canadian subsidiary and the rules in subsection 207.6(5) apply to deem the contributions to be paid to an RCA. If the foreign parent fails to withhold RCA tax from the contributions, the Canadian subsidiary will be jointly liable for any interest, penalties and other amounts payable by the foreign parent in respect of the failure.

New subsection 227(10.2) is applicable on Royal Assent.

Clause 105

Maintenance of Books and Records by Charities

ITA
230(2)

Subsection 230(2) of the Act requires that registered charities and registered Canadian amateur athletic associations keep books and records in order to enable donations that are deductible to be verified.

Subsection 230(2) is amended to enlarge the scope of this record-keeping requirement, to provide that such an organization also keep books and records containing information that will enable the Minister of National Revenue to determine whether there are grounds to revoke the registration of the organization. This amendment to subsection 230(2) applies after December 21, 1992.

Clause 106

Reports to Chief Electoral Officer

ITA
230.1(4) and (5)

Section 230.1 of the Act requires certain books and records to be kept and returns to be filed in respect of contributions to political parties and candidates.

Subsection 230.1(4) of the Act requires the Minister of National Revenue to forward reports to the Chief Electoral Officer based on information in returns received by the Minister of National Revenue from agents of registered political parties and candidates. These reports become public records. Subsection 230.1(5) ensures that such reports will not contain information that would identify a particular contributor to a political party or candidate.

Subsections 230.1(4) and (5) are repealed, effective as of the date of Royal Assent to this amendment. These reporting requirements under the *Income Tax Act* are redundant, in view of the extensive public reporting requirements imposed on political parties and candidates under the provisions of the *Canada Elections Act.*

Clauses 107 and 108

Warrants

ITA
231.1 and 231.3

Section 231.1 of the Act authorizes the inspection, audit and examination of books, records and property of a taxpayer. Subsection 231.1(3) sets out the conditions that must be met for the issuance of a warrant to enter a dwelling-house for these purposes. Section 231.3 of the Act deals with the investigation of tax offences. Subsection 231.3(3) set outs the conditions that must be met for the issuance of a search warrant in that case.

Subsections 231.1(3) and 231.3(3) are amended to clarify that a judge hearing an application for the issuance of a warrant in either case has the discretion not to issue the warrant. This discretion may be exercised even where reasonable grounds to issue the warrant exist. These amendments, which are effective on Royal Assent, respond to a recent decision of the Supreme Court of Canada which held that the absence of a provision for such judicial discretion violates section 8 of the *Canadian Charter of Rights and Freedoms.*

Clause 109

Interpretation

ITA
248

Section 248 of the Act defines a number of terms used in the Act, and also sets out various rules relating to the interpretation and application of various provisions of the Act.

Subclauses 109(1), (3) and (5)

ITA
248(1)

"minerals"
"mineral resource"
"mineral"

Subsection 248(1) of the Act includes definitions of "mineral resource" and "minerals", which are used in the Act and the *Income Tax Regulations* for the purposes of determining a taxpayer's income from mining. A "mineral resource" is defined as deposit of any one of a number of specified substances. "Minerals" is defined to exclude petroleum, natural gas or related hydrocarbons (except coal, bituminous sands, oil sands or oil shale).

Section 248(1) is amended to include as a "mineral resource" a mineral deposit in respect of which the principal mineral extracted is calcium chloride or diamonds.

The definition of "minerals" is repealed and replaced by a new definition of "mineral". The new definition includes calcium chloride, kaolin and silica within its scope.

As a consequence of these amendments, paragraphs 1104(6)(b) and (7)(a) of the *Income Tax Regulations* will be amended to make reference to wells for the extraction of calcium chloride. It is proposed that this amendment be effective for acquisitions in taxation years commencing after 1984.

These amendments apply to taxation years commencing after 1984, except that the reference to kaolin is effective only for the 1988 and subsequent taxation years and the reference to diamond deposits is effective only for the 1993 and subsequent taxation years.

Subclause 109(2)

ITA
248(1)

"employee benefit plan"

Subsection 248(1) of the Act defines an "employee benefit plan" (EBP) as, in general terms, an arrangement under which contributions are made by an employer (or any person not dealing at arm's length with the employer) to another person and under which payments are to be made to the employer's employees. Arrangements referred to in paragraphs (a) to (e) of the definition are excluded. Paragraph (e) excludes "a prescribed fund or plan".

Paragraph (e) of the definition is amended so that it excludes prescribed "arrangements", rather than prescribed funds and plans. This amendment, which applies after 1979, is made so that the exclusion is consistent with the opening words of the definition of an EBP.

Subclause 109(4)

ITA
248(1)

"taxable Canadian property"

Subsection 248(1) of the Act includes both a narrow meaning of "taxable Canadian property", which is derived from the meaning assigned in subsection 115(1), and a broader meaning. That broader meaning, currently applied only for the purposes of section 2 of the Act, adds to the scope of the term: Canadian resource property; timber resource property; income interests in resident trusts; retiring partners' income rights under paragraph 96(1.1)(a) agreements; and life insurance policies in Canada. This amendment to the definition makes the broader meaning of "taxable Canadian property" apply for the purposes of new section 128.1 of the Act. As a result, properties of the types listed above, as well as those within the subsection 115(1) definition, are excluded from the deemed disposition rules provided in paragraphs 128.1(1)(b) and 128.1(4)(b).

This amendment applies after 1992, although it will also apply before that time to corporations electing to be subject to new subsection 250(5.1) of the Act. For further information, reference may be made to the commentary on that provision.

Subclause 109(6)

ITA
248(1)

"securities lending arrangement"

Subsection 248(1) of the Act is amended, applicable to the 1993 and subsequent taxation years, to extend the application of the definition "securities lending arrangement" in subsection 260(1) of the Act to the Act as a whole. This amendment is consequential on the introduction of special provisions relating to securities lending arrangements in Part XIII of the Act.

Subclause 109(7)

ITA
248(9)

"disclaimer"

Paragraph 248(8)(b) of the Act provides that the transfer, distribution or acquisition of a deceased taxpayer's property resulting from a disclaimer, release or surrender will be considered to occur as a consequence of that taxpayer's death, thereby allowing a tax-free rollover of the property in certain cases. While a deadline for filing a release or surrender for these purposes is set out in the definition of "release or surrender" in subsection 248(9) of the Act, no such deadline is set out for the filing of a disclaimer. The definition of "disclaimer" in section 248 of the Act is amended to specify the deadline for the production of a disclaimer for the purposes of subsection 248(8). This deadline, which is the same as the one contained in the definition of "release or surrender" in subsection 248(9), is 36 months from the death of the taxpayer or, where the taxpayer's legal representative has requested an extension of the deadline within that period, such later time as the Minister of

National Revenue considers reasonable in the circumstances. This amendment to subsection 248 is effective on Royal Assent.

Subclause 109(8)

ITA
248(23) and (23.1)

New subsection 248(23.1) of the Act applies to certain transfers, distributions and acquisitions of property occurring after the death of a taxpayer and resulting from the laws of a province relating to the sharing of property as a result of a marriage. New subsection 248(23.1) deems these transactions to have occurred either as a consequence of the death of the taxpayer (in the case of property transferred to the deceased taxpayer's spouse) or immediately before the time that is immediately before the death of the taxpayer (in the case of property transferred to the deceased taxpayer's estate). In this way, such transactions may benefit either from the tax-free rollover of property between spouses on death provided for in subsection 70(6) of the Act or from the tax-free rollover between living spouses provided for in subsection 73(1) of the Act.

The laws of a province referred to in new subsection 248(23.1) are those that provide for the sharing of certain assets owned or acquired by a spouse during marriage. These laws include laws dealing with matrimonial regimes and those that provide for the sharing of property used by spouses during a marriage. The subsection applies to assets transferred from a deceased taxpayer to a spouse as well as to assets transferred from a deceased taxpayer's spouse to the deceased taxpayer's estate.

Subsection 248(23) is amended as a consequence of the introduction of new subsection 248(23.1). Property transferred between spouses as a result of the dissolution of a matrimonial regime as a consequence of death will now be governed by subsection 248(23.1).

This amendment applies to dissolutions and deaths occurring after December 21, 1992.

Subclause 109(9)

ITA
248(25)

Subsection 248(25) of the Act provides that a person or partnership is "beneficially interested" in a trust if that person or partnership has any right to receive any of the income or capital of the trust either directly from the trust or indirectly through one or more trusts.

This amendment to subsection 248(25), which applies after 1990, ensures that a person or partnership is considered to be beneficially interested in a particular trust only where the right to receive income or capital of the trust is associated with the person's or partnership's status as a beneficiary under a trust.

Clause 110

Year-End on Change of Control

ITA
249(4)(c)

Where control of a corporation is acquired by a person or group of persons at any time, subsection 249(4) of the Act treats the taxation year of the corporation as having ended immediately before that time and a new taxation year of the corporation as having commenced at that time. Where the taxation year deemed to have ended was not more than seven days long, paragraph 249(4)(c) allows the corporation to extend the previous year (provided it was longer than seven days) so that it ends immediately before the acquisition of control. This election to extend the previous year is not available in certain circumstances, including where that year itself ended because of the corporation's emigration. This amendment to paragraph 249(4)(c), which forms part of a set of amendments concerning taxpayers' residence and certain related matters, replaces the reference to paragraph 88.1(c) with a reference to new section 128.1.

This amendment applies after 1992, although it will also apply before that time to corporations electing to be subject to new subsection 250(5.1) of the Act. For further information, reference may be made to the commentary on that provision.

Clause 111

Residence

ITA
250

Section 250 of the Act provides an expanded definition of a resident of Canada for purposes of the Act.

Subclause 111(1)

ITA
250(1)(f)

Pursuant to paragraph 250(1)(f) of the Act, dependent children of certain persons deemed to be resident in Canada are also deemed to be Canadian residents if the children's income does not exceed the basic personal amount ($6,456 for 1993). The amendment to paragraph 250(1)(f), which applies beginning in 1993, ensures that only children dependent for support on persons deemed to be resident in Canada by reason of any of paragraphs 250(1)(b) to (d.1) are deemed to be resident in Canada.

Subclause 111(2)

ITA
250(5.1)

In many jurisdictions, a company incorporated elsewhere may be naturalized by submitting to the corporate law of its new home. Such an action is often described as a corporate "continuance" or "continuation". New subsection 250(5.1) of the Act, together with certain concurrent amendments concerning taxpayers' residence, fixes the tax consequences of continuation into a different jurisdiction. The basic principle of subsection 250(5.1) is that the continued corporation will be treated as having been incorporated in the jurisdiction into which it has continued. A corporation, for example, that was originally incorporated in Canada but was subsequently continued abroad will cease to be treated as having been incorporated in Canada, and will therefore no longer for that reason be deemed to be resident in Canada (although it may remain resident by keeping its central management and control in this country). Similarly, a corporation incorporated abroad -- or incorporated in Canada and earlier continued abroad -- will become resident in Canada on being continued here. It should be noted that the continued corporation is treated as having been incorporated in its new home jurisdiction only for the purpose of applying the Act from the time of continuation (and only until continuation into a different jurisdiction).

In applying most provisions of the Act, a corporation's deemed incorporation under subsection 250(5.1) will be considered to have taken place as of the date of its original incorporation. Paragraph 250(5.1)(b), however, provides that for the purposes of applying subsection 250(4) - under which Canadian residence may depend on the date of incorporation - the continued corporation will be treated as having been incorporated, in the jurisdiction into which it has continued, as of the date of that continuance.

This amendment applies after 1992. In addition, a corporation that was continued at any time before 1993 may elect to have this amendment apply as of the time of its continuation. Similarly, a corporation continued before July 1994 may elect not to have the amendment apply to its continuation, provided there is written evidence that arrangements for the continuation were substantially advanced before December 21, 1992. Either election must be made by notifying the Minister of National Revenue in writing before the end of the sixth month following the month in which this amendment receives Royal Assent. It should be noted that because new subsection 250(5.1) forms part of a set of amendments regarding residence and certain related matters, any corporation making this election will be subject to those provisions as well. The following table lists all the relevant amendments by *Income Tax Act* section numbers. Unless otherwise noted, these changes will apply, in the case of a corporation making the election described above, as of the time of its continuation.

ITA	Subject	Notes
44(2)(d)	timing of disposition	
48	changes in residence	repealed
52(8)	cost of shares	new - applies after 1992
54(i)(iii)	"superficial loss"	
88.1	corporate migration	repealed
89(1)(a)	"Canadian corporation"	applies after Royal Assent
89(1)(c) (ii)(C)	"paid-up capital"	
98.1(1)(a)	residual partnership interest	
128.1	changes in residence	new
128.2	cross-border mergers	new
219.1	corporate emigration	
248(1)	"taxable Canadian property"	
249(4)(c)	year-end	
250(5.1)	continued corporation	
ITAR 26(10)	cost of property	

Clause 112

Extended Meaning of Spouse

ITA
252(4)

Subsection 252(4) of the Act provides that the term "spouse" of a taxpayer generally includes a person of the opposite sex who has been cohabiting with the taxpayer in a conjugal relationship for at least 12 months or who is a parent of a child of whom the taxpayer is also a parent. This amendment to subsection 252(4), which applies after 1992, ensures that, for these purposes, only a natural or adoptive child (and not, for example, a daughter-in-law or son-in-law) will be considered.

Clause 113

Union Employer

ITA
252.1

New section 252.1 provides that a union and its locals and branches are considered to be a single employer for the purposes of certain of the retirement savings rules. The new section applies, first, for the purposes of the provisions relating to the computation, reporting and application of pension adjustments (Pas) and past service pension adjustments (PSPAs). This will ensure, for example, that an individual who is employed by both the national and a local of a union is not, as a result, entitled to pension benefits under a registered pension plan in excess of those permitted to an individual with a single employer. The section applies commencing with PAs and PSPAs for 1995.

Second, section 252.1 is applicable commencing in 1995 for the purpose of determining whether a pension plan is a multi-employer plan (MEP) or a specified multi-employer plan (SMEP). The criteria for qualification as a MEP are in subsection 8500(1) of the *Income Tax Regulations* and for qualification as a SMEP are in subsection 8510(3) of the Regulations. The rule will ensure that a plan is not considered to have more than one participating employer simply because a union and its various locals participate in the plan.

Third, section 252.1 applies, commencing October 8, 1986, with respect to subsection 207.6(5.1) of the Act. That subsection determines which contributions made to a foreign pension plan are subject to the retirement compensation arrangement (RCA) tax pursuant to subsection 207.6(5) of the Act. Section 252.1 is relevant, in particular, for the application of proposed section 6804 of the Regulations (released by the Minister of Finance on December 18, 1992), which prescribes certain contributions as contributions that are excluded from the application of subsection 207.6(5.1).

Fourth, the section applies with respect to the provisions of the Act relating to a failure to withhold RCA tax from contributions to an RCA or to remit tax that was withheld. The provisions relating to a failure to withhold include subsections 227(8) (penalty for failure to withhold), 227(8.2) (liability to pay an amount equal to the tax not withheld), and 227(8.3) (interest on tax not withheld). The provisions that apply on a failure to remit include subsections 227(9) (penalty for failure to remit), 227(9.2) (interest on amounts withheld but not remitted), and 227(9.4) (liability to pay amount not remitted). The section first applies with respect to failures to withhold or remit in respect of contributions made in 1992.

Clause 114

Acquisitions of Control

ITA
256(7)

Subsection 256(7) of the Act describes circumstances in which control of a corporation will be treated as not having been acquired for the purposes of certain provisions of the Act. The preamble to subsection 256(7) is amended to include among those provisions new subsection 87(2.11), which allows a corporation formed through a vertical amalgamation to apply its post-amalgamation losses against the pre-amalgamation income of its predecessor parent corporation.

In addition, paragraph 256(7)(a) of the Act is amended to clarify its application. Subparagraph 256(7)(a)(i), as amended, provides that the acquisition of a particular corporation's shares will not, in certain circumstances, by itself result in an acquisition of the control of that or any other corporation. Those circumstances include: the acquisition of shares by any person from a related person; the acquisition of shares, from any person, by a person related to the particular corporation; the acquisition of shares by an estate; and the acquisition of shares by any person from the estate of a related person. As a result, amended subparagraph 256(7)(a)(i) applies not only to all the share acquisitions covered by the existing paragraph 256(7)(a), but also to a number of other cases not explicitly accommodated by the existing rule, such as the acquisition of the shares of a corporation by a group of persons related to the corporation.

Amended subparagraph 256(7)(a)(ii) provides that control of a particular corporation will not be considered to have been acquired because of the redemption or cancellation of shares of that corporation or another corporation controlling it, provided the corporation is controlled, after the redemption or cancellation, by a person or group related to the corporation before that event.

These changes apply to acquisitions, redemptions and cancellations occurring after 1992.

Clause 115

Qualified Trusts

ITA
259

Section 259 of the Act provides a "look-through" rule which applies where one or more taxpayers described in section 205, including trusts governed by a registered pension plans and registered retirement savings plans, acquire interests in a "qualified trust". If the qualified trust so elects, such taxpayers will be deemed to acquire, hold and dispose of proportionate percentages of the underlying trust property for the purposes of the rules relating to the acquisition, holding and disposition of non-qualified investments and the holding of foreign property.

Section 259 is amended so that it applies to each unit of a qualified trust. As more specifically described below, this amendment recognizes that taxpayers may increase or decrease their units in a qualified trust at any time and should, accordingly, be considered to have acquired or disposed of underlying trust property at such time.

The key definition in amended section 259 is "specified portion", which under amended paragraph 259(1)(b) is determined with respect to each unit in a qualified trust. The specified portion in respect of a unit at any particular time is 1 (assuming the unit is a whole unit) divided by the number of units in the trust outstanding at that time. Where the unit is a fraction of a whole unit, the specified portion is that fraction divided by the number of outstanding units. The overall effect of the new rules for a taxpayer is determined by applying the new rules below to each unit (or fraction of a unit) held by a taxpayer.

Under amended paragraph 259(1)(b), a taxpayer is deemed to hold at any time the specified portion at that time of each property of a qualified trust. The cost amount at that time of the taxpayer's "deemed" property is, by virtue of amended paragraph 259(1)(c), the specified portion of the cost amount to the trust of its property. As paragraphs 259(1)(b) and (c) apply on a unit-by-unit basis, their overall effect is that the cost amount to such a taxpayer of the underlying trust property is based on the taxpayer's total units in the trust. These paragraphs are thus consistent with existing paragraph 259(1)(b).

As a consequence of an election by a qualified trust under subsection 259(1), a taxpayer holding a unit in the trust is deemed under amended paragraph 259(1)(d) to acquire at a particular time the specified portion (determined at the particular time) of a trust property, provided that the particular time is the later of

- the time the trust acquired such property, and
- the time the taxpayer acquired the unit.

The fair market value of the specified portion of the underlying trust property at the time of such deemed acquisition is deemed by amended paragraph 259(1)(e) to be the specified portion at that time of the fair market value of the trust property at the time of its actual acquisition by the trust. Amended paragraphs 259(1)(d) and (e) correspond to the existing rules in paragraph 259(1)(c).

New paragraphs 259(1)(f) and (g) provide rules which deem a taxpayer to dispose of trust property, where the trust disposes of any of its property or the taxpayer disposes of a unit in the trust. More specifically,

- where the trust disposes of a property at any time, the taxpayer is deemed at that time to have disposed of the specified portion (determined immediately before that time) of that property for proceeds equal to such portion of the proceeds of disposition of that property to the trust, and

- where the taxpayer disposes of a trust unit at any time, the taxpayer is deemed at that time to have disposed of the specified portion (determined immediately before that time with respect to that unit) of the underlying trust property for proceeds equal to such portion of the fair market value of the underlying trust property.

New paragraph 259(1)(h) is introduced to ensure that property deemed to be acquired by a taxpayer under paragraph 259(1)(d) retains its character when it is deemed to be disposed of by the taxpayer under paragraph 259(1)(f) or (g), notwithstanding that the taxpayer's proportion of the units in a trust may have increased or decreased between the date of the deemed acquisition and the deemed disposition. The purpose of this rule is to ensure that RRSP and RRIF annuitants may enjoy benefits resulting from the application of subsection 146(6) or 146.3(8) or Part X of the Act to the disposition of a non-qualified investment.

Subsection 259(2) of the Act is introduced so that the look-through rule described above also applies, with all necessary changes, where a taxpayer holds shares in the capital stock of a "qualified corporation" and the corporation so elects. (Former subsection 259(2) is renumbered as subsection 259(3).) A "qualified corporation" is defined in new subsection 259(5) as a corporation described in paragraph 149(1)(o.2) if all its issued and outstanding shares are identical to each other or are owned by one person.

Subsection 259(4) of the Act is introduced to ensure that an electing trust or corporation is required to provide sufficient information to its unit holders or shareholders for them to be able to determine the consequences of an election. More specifically, the electing trust or corporation is required to notify unitholders or shareholders of the election not more than 30 days after making the election. The electing trust or corporation must also provide unitholders or shareholders with any additional requested information necessary for them to determine the consequences of the election.

Except for the introduction of subsections 259(2) and (4), these amendments apply after 1985. New subsection 259(2) applies after 1991. New subsection 259(4) applies to elections made after December 21, 1992.

Clause 116

Securities Lending

ITA
260(8)(a)(iii)

Subsection 260(8) of the Act provides special rules applying for the purposes of Part XIII of the Act to payments made under securities lending arrangements. New subparagraph 260(8)(a)(iii) treats securities described in paragraph (c) of the definition of qualified security in subsection 260(1) of the Act (generally, domestic or foreign government debt obligations) as securities described in subparagraph 212(1)(b)(ii) of the Act for the purposes of Part XIII. Thus, where a payment made under a securities lending arrangement to a non-resident by a securities borrower resident in Canada is treated by subparagraph 260(8)(a)(i) of the Act as a payment of interest payable on the underlying security, that payment will be exempt from Part XIII tax if the underlying security is a foreign government bill.

New subparagraph 260(8)(a)(iii) applies to securities lending arrangements entered into after May 28, 1993.

Clause 117

Life Insurance Corporations

The amendments dealing with life insurance corporations in sections 138, 181.3, 190.1, 190.11, 190.13, 190.15 and 190.16 of the Act will, upon enactment, have the potential to alter a corporation's tax liability for its 1992 and, in some cases, 1991 taxation years. The provision in this clause does not limit or otherwise alter the effect of these amendments on a corporation's tax payable under the Act for those years, but does eliminate any impact that they may have on the corporation's liability for interest under the Act – for example, in respect of instalments required to be made under section 157 and subject to interest under section 161 – for periods prior to March 15, 1993.

Clause 118

Changes in Residence

ITAR
26(10)

Subsection 26(10) of the *Income Tax Application Rules* provides that where subsection 48(3) of the *Income Tax Act* applies to deem the cost to a taxpayer of any property, the rules in section 26 do not apply to determine that cost to be any other amount. This clause, which is consequential to a set of amendments concerning taxpayers' residence and certain related matters, amends subsection 26(10) to refer to new paragraph 128.1(1)(b) of the *Income Tax Act*, as well as subsection 48(3) of the Act.

This amendment applies after 1992, although it may also apply before that time to corporations electing to be subject to new subsection 250(5.1) of the Act. For further information, reference may be made to the commentary on that provision.

Clauses 119 and 120

Application of Part XII.1 of the *Income Tax Act*

ITAR
72(a) and 73(a)

The 5th Supplement to the *Revised Statutes of Canada*, 1985 contains the *Income Tax Act* and the *Income Tax Application Rules* (ITAR) that apply to taxation years and other periods ending, and certain events occurring, after November 1991. Section 73 of the ITAR specifies the periods or events to which the various parts of the version of the *Income Tax Act* contained in the 5th Supplement apply, while section 72 specifies the periods or events to which the various parts of the former version of the *Income Tax Act* continue to apply.

The amendments to section 72 and 73 of the ITAR correct an oversight in the 5th Supplement by adding to those sections references to Part XII.1 of the *Income Tax Act*. The amendments provide that Part XII.1 of the former version of the *Income Tax Act* applies to taxation years that end before December 1991, and that Part XII.1 of the 5th Supplement version of the *Income Tax Act* applies to taxation years that end after November 1991. These amendments are deemed to come into force on March 1, 1994, the date on which the 5th Supplement came into force.

Clause 121

Effect of Amendments on Former *Income Tax Act*

ITAR
79

New section 79 of the ITAR deals with amendments to the *Income Tax Act* or the ITAR that are retroactive to periods, transactions or events the occurred before the periods, transactions or events to which the 5th Supplement version of the *Income Tax Act* or the ITAR applies. This new section provides that the former version of the *Income Tax Act* or the ITAR shall be read as if it had been amended by any such retroactive amendments with respect to those earlier periods. New subsection 79 of the ITAR is deemed to have come into force on March 2, 1994, the day after the date of the coming-into-force of the 5th Supplement and the *Income Tax Amendments Revisions Act.*

Clause 122

Schedule to the 5th Supplement

The Schedule to the 5th Supplement sets out the extent of the repeal of the various parts of the former version of the *Income Tax Act.* The amendment to the Schedule, by adding a reference to Part XII.1 of the former version of the *Income Tax Act*, provides that Part XII.1 of the former Act is repealed with respect to taxation years that end after November 1991. Section 73 of the ITAR is also being amended to provide that Part XII.1 of the 5th Supplement version of the *Income Tax Act* applies to taxation years that end after November 1991.

Clause 123

CPP Withholding

CPP
23(3) and (4)

Subsection 23(3) of the *Canada Pension Plan* provides that amounts deducted from remuneration by an employer on account of Canada Pension Plan contributions of an employee are deemed to be held in trust for Her Majesty. Subsection 23(3) is amended, effective on Royal Assent, to clarify that the deemed trust arising in respect of contributions withheld is impressed on the funds at the time the amounts are withheld.

Subsection 23(4) of the Act provides that, in the event of the liquidation, assignment, receivership or bankruptcy of or by an employer, such amounts will not form part of the estate of that person, notwithstanding the provisions of the *Bankruptcy Act.* This subsection is repealed, effective on Royal Assent, as amendments to the *Bankruptcy Act* have made these provisions redundant.

Clause 124

Instalments of CPP

CPP
34(4)

Subsection 34(4) of the *Canada Pension Plan* provides rules to determine the minimum instalments of Canada Pension Plan (CPP) contributions that a self-employed person has to make, as well as rules to calculate interest charges on deficient CPP instalments. This amendment to subsection 34(4), which applies to 1992 and subsequent years, clarifies that, for the purposes of calculating such interest, the minimum instalment required to be paid on each due date by a self-employed person is the amount that will bring the total instalments paid to date equal to the lowest total amount required to be paid by the person by that date.

Clause 125

Labour-Sponsored Venture Capital Corporations

CBCA
174

Subsection 49(9) of the *Canadian Business Corporations Act* (CBCA) provides that a corporation that issues shares to the public is generally not permitted to have a restriction on the issue, transfer or ownership of its shares except by way of a constraint permitted under subsection 174(1) of the CBCA. Under subsection 174(1), a corporation may by special resolution amend its articles to provide for such a constraint.

Subsection 174(1) of the CBCA is amended to permit a corporation to constrain the issue, transfer or ownership of its shares in order to enable it to be a registered labour-sponsored venture capital corporation under Part X.3 of the *Income Tax Act*.

This amendment applies after 1988.

Clause 126

Employee and Shareholder Benefits

ETA
173

Section 173 of the *Excise Tax Act* provides rules for determining whether Goods and Services Tax (GST) is payable in respect of an amount required to be included as a taxable benefit in determining the income of an employee or a shareholder under the *Income Tax Act*.

Subclause 126(1)

ETA
173(1)(b) (French version)

Subclause 122(3) of this Bill adds new subparagraph 173(1)(e)(vii) to the English version of the Act. A corresponding amendment to the French version of the Act adds subparagraph 173(1)(b)(iii) to that version. As a consequence, the subsequent subparagraphs in paragraph 173(1)(b) of the French version are renumbered.

Subclause 126(2)

ETA
173(1)(c)

Paragraph 173(1)(c) of the Act is amended to add references to new paragraphs 6(1)(k) and (l) of the *Income Tax Act*. Those paragraphs require an employee to include in income certain amounts representing automobile operating cost benefits enjoyed by the employee.

Subclause 126(3)

ETA
173(1)(e)(vi) and (vii)

Subparagraph 173(1)(e)(vi) of the Act provides for the time that the GST applicable to employee or shareholder benefits is deemed to be collectible and to have been collected by the registrant conferring the benefit. This amendment to subparagraph 173(1)(e)(vi) adds references to new paragraphs 6(1)(k) and (l) of the *Income Tax Act* to reflect the fact that benefits pertaining to automobile operating expenses are to be included under those new paragraphs.

Subparagraph 173(1)(e)(vii) provides a new rule for calculating the GST to be remitted by registrants in respect of automobile operating cost benefits that are conferred on employees or shareholders and that are required, under paragraphs 6(1)(k) or (l), or subsection 15(1), of the *Income Tax Act* to be included in the income of the employee or shareholder. In these cases, the GST to be remitted is equal to the prescribed percentage (which will be set at 5%) of such benefits.

Clauses 127 and 128

Warrants

ETA
288(3) and 290(3)

Section 288 of the *Excise Tax Act* authorizes the inspection, audit and examination of documents, property and processes of a person. Subsection 288(3) sets out the conditions that must be met for the issuance of a warrant to enter a dwelling house for these purposes. Section 290 of the *Excise Tax Act* sets out rules for the investigation of offences under that Act, including, in subsection 290(3), the conditions that must be met for the issuance of a search warrant. Sections 288 and 290 are similar to sections 231.1 and 231.3 of the *Income Tax Act*, to which amendments are included in this legislation.

Subsections 288(3) and 290(3) of the *Excise Tax Act* are amended, in the same manner as sections 231.1 and 231.3 of the *Income Tax Act*, to clarify that a judge hearing an application for the issuance of a warrant has the discretion not to issue the warrant. This discretion may be exercised even where reasonable grounds to issue the warrant exist. These amendments, which are effective on Royal Assent, respond to a recent decision of the Supreme Court of Canada which held that the absence of a provision for such judicial discretion violates section 8 of the *Canadian Charter of Rights and Freedoms*.

Clause 129

Remittances

UI
53(1)

Subsection 53(1) of the *Unemployment Insurance Act* authorizes employers to withhold required employee U.I. premiums. The amount withheld is currently based on tables prepared by regulation. This subsection is amended to provide that the amount to be withheld is to be determined in accordance with prescribed rules. This will allow regulations to be made on a more timely basis than is currently the case. Revenue Canada, Taxation will continue to provide source deduction tables to employers.

This amendment applies after 1994.

Clause 130

UI Withholding

UI
57(2) and (3)

Subsection 57(2) of the *Unemployment Insurance Act* provides that amounts deducted from remuneration by an employer on account of unemployment insurance premiums of an employee are deemed to be held in trust for Her Majesty. Subsection 57(2) is amended, effective on Royal Assent, to clarify that the deemed trust arising in respect of premiums withheld is impressed on the funds at the time the amounts are withheld.

Subsection 57(3) of the Act provides that, in the event of the liquidation, assignment, receivership or bankruptcy of or by an employer, such amounts will not form part of the estate of that person, notwithstanding the provisions of the *Bankruptcy Act.* This subsection is repealed, effective on Royal Assent, as amendments to the *Bankruptcy Act* have made these provisions redundant.

Clause 131

Premium Tables

UI
75

Subclause 131(1)

UI
75(1)(p)

Subsection 75(1) of the *Unemployment Insurance Act* allows the Minister of National Revenue, with the approval of the Governor in Council, to make regulations necessary for the administration of that Act. Paragraph 75(1)(p) of the Act authorizes the making of regulations to provide tables respecting the payment of premiums. As a consequence of the amendment to subsection 53(1) of the Act to provide that the premiums to be withheld are to be determined in accordance with prescribed rules, the authority to provide tables by regulation is no longer required and is therefore repealed, effective after 1994.

Subclause 131(2)

UI
75(5)

Subsection 75(5) of the *Unemployment Insurance Act* provides that tables made under the authority of paragraph 75(1)(p) of the Act may be effective retroactively. As a consequence of the amendment to subsection 53(1) of that Act to require that the amount of the premiums to be withheld be determined in accordance with prescribed rules, this retroactive power is granted to the annual amendment of the rules.

This amendment applies after 1994.

Clause 132

Carrying Charges

S.C. 1988, c.55, s.10

ITA
18(2)

Subsection 18(2) of the Act prohibits the deduction of interest and property taxes on vacant land to the extent that these expenses exceed any income from the land. For corporations whose principal business is the leasing, rental or sale, or the development for lease, rental or sale, of real property, an additional amount of such carrying charges incurred in a year may be deducted, up to the corporation's base level deduction (generally, $1 million times the prescribed rate of interest for the year).

These restrictions on the deduction of carrying charges were introduced in section 10 of the *Statutes of Canada*, 1988, c.55 (Bill C-139), applicable to taxation years ending after 1987. Transitional relief was provided in the form of a five-year phase-in applicable to taxation years ending before 1992. Where a taxation year does not coincide with a calendar year this phase-in is deficient because it does not account for the portion of the 1992 taxation year that falls in 1991. The transitional provision is therefore amended effective as of September 13, 1988, to provide application of the phase-in to portions of those taxation years that end before 1993 rather than before 1992. This amendment ensures that the full benefit of the phase-in for the calendar year 1991 is available to all taxpayers regardless of the date on which their taxation year ends.

Clause 133

Securities Lending – Deduction for Traders

S.C. 1990, c. 39

ITA
260(6) and (7)

Section 260 of the *Income Tax Act*, which was introduced by section 55 of S.C. 1990, c.39 (Bill C-28), sets out the rules relating to securities lending arrangements.

The coming-into-force provision in S.C. 1990, c. 39 for subsections 260(6) and (7) of the *Income Tax Act*, as amended by S.C. 1991, c. 49, provides a deduction to persons registered or licensed under the laws of a province to trade in securities for 2/3 of dividend compensation payments made before 1993 under securities lending arrangements, and treats 1/3 of such payments as taxable dividends paid for the purposes of section 129 of the Act. This amendment extends the effect of these rules to such payments that are made before July 1994.

Clauses 134 and 135

Maintenance Payments

S.C. 1993, c. 24

ITA
56.1 and 60.1

Paragraphs 56(1)(b) and 60(b) of the *Income Tax Act* provide that maintenance payments made pursuant to a court order or written agreement are deductible by the payer and included in the income of the recipient. Subsections 56.1(3) and 60.1(3) of the Act allow individuals to chose this treatment under certain circumstances where the payments have been made before the written agreement or court order is formalized.

These provisions were amended in S.C. 1993, c. 24 (Bill C-92) to implement the 1992 Budget measures recognizing common-law relationships. As part of these amendments, the requirement that individuals be separated pursuant to a divorce, judicial separation agreement or written separation agreement at the time the maintenance payment was made and throughout the remainder of the year was dropped from paragraphs 56(1)(b) and 60(b), effective for breakdowns of marriages occurring after 1992. Subsections 56.1(3) and 60.1(3) were correspondingly amended to delete the provision that deemed individuals to meet this requirement in respect of payments made before the order or agreement had been entered into, effective for orders and agreements entered into after 1992.

The two coming-into-force provisions for these amendments created a transitional problem for individuals whose marriages break down in 1992, and who receive maintenance orders or enter into agreements in 1993. These amendments, which apply as of June 10, 1993 (the date on which Bill C-92 received Royal Assent), correct this problem.

Clause 136

Registered Retirement Savings Plans

S.C. 1993, c. 24

ITA
146(5)

S.C. 1993, c. 24 (Bill C-92) included an amendment to subsection 146(5) of the *Income Tax Act*, affecting the calculation of an individual's deduction limit for RRSP contributions where the individual has claimed a deduction under subsection 147.3(13.1). Subsection 146(5) of the Act is being amended, as described in the commentary to that subsection, in order to correct an anomaly arising from this earlier amendment.

The amendment to subsection 146(5) contained in Bill C-92 was to apply for the 1992 and subsequent taxation years, with a special transitional rule for the 1992 taxation year. Because of the amendment contained in this Bill, this transitional rule is neither necessary nor appropriate. As a consequence, it is being eliminated, effective as of June 10, 1993, the date on which Bill C-92 received Royal Assent.

Clause 137

Non-Resident Withholding Tax

S.C. 1993, c. 24

ITA
212

Section 212 of the *Income Tax Act* imposes a withholding tax on certain payments to non-residents. Subparagraph 212(1)(b)(iv) provides an exception from that tax for interest payable on certain obligations to a non-resident holding a certificate of exemption issued under subsection 212(14). Subparagraph 212(1)(b)(iv) was amended by S.C. 1993, c. 24 (Bill C-92) to provide that this exception is available only where the payor and the recipient of the interest deal at arm's length. That amendment generally applies to amounts paid or credited after 1991. For obligations issued before 1992, however, the amendment applied only to amounts paid or credited after 1992.

This amendment extends the transitional period for this change to the non-resident withholding tax rules by two years in respect of obligations acquired before 1992, so that the arm's-length requirement will only apply after 1994. It should be noted that this transitional rule, which is intended to give existing certificate holders time to adapt to the arm's length requirement, applies only where the recipient of the interest, or a person related to the recipient, acquired the debt obligation in question before 1992.

This amendment applies as of June 10, 1992, the date on which Bill C-92 received Royal Assent.

Clause 138

Eligible Capital Property – Cost Amount

S.C. 1993, c. 24

ITA
248

S.C. 1993, c. 24 (Bill C-92) amended the definition of "cost amount" in subsection 248(1) of the *Income Tax Act*. Among other things, these amendments provide that the prorated cumulative eligible capital of a taxpayer is multiplied by 4/3. This 4/3 multiplication factor is necessary to take into account the 75 per cent inclusion rate applicable to dispositions of eligible capital property.

This amendment provides that this change to the definition of "cost amount" applies, in the case of corporations, to taxation years beginning after June 1988, the time at which the inclusion rate applicable to dispositions of eligible capital property by corporations changed from 50 per cent to 75 per cent, rather than after June 1987.

This amendment applies as of June 10, 1993, the date on which Bill C-92 received Royal Assent.